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THE ADMINISTRATION'S BUDGET PROPOSAL FOR THE SBA FOR FISCAL YEAR 1988

HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

ON

THE ADMINISTRATION'S BUDGET PROPOSAL FOR THE SBA FOR FISCAL YEAR 1988

FEBRUARY 24, 1987

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February 24:
Afternoon session 1

THE ADMINISTRATION'S BUDGET PROPOSAL FOR THE SBA FOR FISCAL YEAR 1988

TUESDAY, FEBRUARY 24, 1987

U.S. SENATE,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The committee met, pursuant to notice, at 2:20 p.m. in room 428A, Russell Senate Office Building, Hon. Dale Bumpers (chairman of the committee) presiding.

The CHAIRMAN. The Committee will come to order. Our first witness is not here, but we also have some business to take care of this afternoon. But we have to quorum before we can transact business. So let me just begin with my opening statement and then I will afford the same privilege to the other members of the panel who wish to make opening statements.

STATEMENT OF HON. DALE BUMPERS, A U.S. SENATOR FROM THE STATE OF ARKANSAS

The CHAIRMAN. First, I am pleased to convene this hearing today, my first as Chairman of the Committee, to examine the Administration's budget proposal for fiscal year 1988. Please let me acknowledge, and I wish he were here, that Senator Lowell Weicker, for the past 6 years has given this Committee exemplary leadership. And if it had not been for him, it is not to embellish to say that we would not be here at all today.

Second, I want to commend President Reagan for having found religion and abandoned his opposition to SBA. While members of Congress can claim some credit, the President was just wise enough to see that his administration's opposition was mistaken, and happily, the 1988 proposed budget calls for the continuation of the SBA.

There are a number of aspects of this budget which I find disturbing, not the least of which is the bottom line. The proposal keeps most existing programs in place and asks for a rather modest $379.3 million in budget authority. When one factors in the proposed $643 million in revenue from asset sales, as well as a proposed $88 million in new revenue from user fees charged small businesses, the net result is negative outlays or cash in fist, of $351.7 million next year, from the continuation of SBA.

User fees alone will pay almost one-third of the cost of the entire salaries and expenses of 4,200 employees in the Agency.

With gimmicks such as this, it must have been easy for the President to reverse his decision and decide in favor of the SBA. As

to the specifics of this budget, I have grave concerns about the hundreds of proposed changes. But at least we seem to have no disagreement that the essential small business assistance programs in the areas of management counseling help with Federal procurement and contracting—and when the private sector fails to meet the need—financial assistance to small and growing businesses. In an era when our ability to compete with the red hot economies of the Pacific rim, and those of our allies in Europe is being severely tested, it would be foolhardy to abandon Federal efforts to provide essential resources to small entrepreneurs, who annually account for over 80 percent of all the new jobs created in this Nation.

The budget which will be considered here today proposes many changes in SBA's four programs, which I find troublesome. Incidentally, no one seems to remember that in the 1986 budget, which Senator Weicker worked out with the Administration, with my support, we reduced SBA spending by two and a half billion dollars over a 3 year period. And now those savings seem to have been forgotten. First, in the section 7(a), Guaranteed Lending Program, the most well-known of all SBA programs, this budget would double the guarantee fee charged to small business borrowers by raising the up-front fee from 2 to 4 percent. It is suggested that only three points will be paid by the borrower, with one point being charged directly to the lender, that is, the bank. And I fail to see how SBA could assure us that this is not going to be passed along to the borrower through higher interest rates and other charges. We will hear testimony on that point later today.

Second, the Administration proposes a large number of new user fees, or charges for services which had heretofore been paid for by tax revenues through normal appropriations channels.

In the small but important area of SBA Publications, for example, the Administration proposes to increase revenue from sales of pamphlets from about $120,000 all of last year to $946,000 in 1988.

For SBA's two great volunteer-driven programs, the Service Corps of Retired Executives, and the Active Corps of Executives, the Administration is proposing to collect fees—which then become general treasury revenue—from small business people who avail themselves of these voluntary contributions of time and knowledge by the experienced business leaders who freely staff these programs.

This particular proposal strikes me as extraordinarily cynical, and is a contradiction of the President's stated intention to encourage volunteerism. Although the substance of the SCORE and ACE programs is free--because the members volunteer the wisdom of their experience to other aspiring entrepreneurs, the Administration proposes to effectively place a tax on this volunteerism, by charging a fee to small business participants. The voluntary contribution of America's retired business executives—given with no expectation of compensation—would be converted into a moneymaker for the Federal Treasury, which would bring in $1.8 million in Federal revenues. Additionally, I note that if one puts a pencil to SBA's revenue estimates, it is clear that attendance and participation in these programs is expected to fall dramatically with implementation of these new fees.

Further, in the area of SBA's procurement assistance programs, which have saved the Government untold billions of dollars over the years by helping small businesses compete for Federal contracts, the Administration proposes to levy a fee of $10 on a business, merely to have its name placed in SBA's computerized registry of suppliers, a system known as PASS. Thirty dollars per hour would be charged to those businesses which use PASS to find subcontractors. The Administration estimates it will raise $1.47 million for this scheme, which seems to discourage participation in the program, which annually saves the government many times its cost in tax dollars.

Third, the budget proposes a 5-year phase out of the widely used Small Business Development Center Program, which provides essential management and technical assistance to local businesses through university based centers. The plan seems at odds with recommendation Number 60 of the White House Conference on Small Business, which calls for the SBDC program to be strengthened and expanded to provide greater outreach to the business community.

And finally, the President's budget proposal seems premised on cannibalizing more than enough of SBA's income-producing loan portfolio, to fund the entire operations of the agency for the next year. In fiscal year 1988, the Administration proposes to sell assets having a face value of $2.240 billion for an estimated $640 million or an average of 33 percent return of each tax payer's dollar. Some of these loans, the general business direct loans, of which SBA now holds some $1.3 billion—are, according to the proposal, likely to sell for only 14 percent of face value. The Administration evidently intends to go ahead with the sale of $800 million in SBA Disaster Loans, with the accompanying mortgages on homes, farms, and businesses, within the remaining months of fiscal 1987. And they seem intent on doing so without any authorization from Congress. The proposal assumes the sale of all assets, without any recourse to the government, which is an unprecedented scheme, and contrary, even to the most recent sale of SBA loans in 1976, under the Ford administration.

In the last Congress, this Committee refused to acquiesce in a without-recourse sale of assets, because our hearings and evidence indicated the value of loans then in question, would be reduced from as high as a dollar and 12 cents on each dollar of face value, to as low as 60 cents on the dollar. And presently, the Administration estimates only 49.3 cents on the dollar for the same Economic Development Loans.

Our Committee was a voice crying in the wilderness on this issue last year, but I intend to fully pursue the matter again in this budget cycle, and expect to hold a hearing on the question of "with or without recourse," in the event the budget resolution mandates an asset sale.

I look forward to the testimony of Mr. Heatherly, the Deputy Administrator, and Acting Administrator of SBA, as well as that of a distinguished panel of small business lenders and participants in SBA's programs. Now I would like to yield to my distinguished colleague, Ranking Member Senator Weicker, for his comments.

STATEMENT OF HON. LOWELL WEICKER, JR., A U.S. SENATOR FROM THE STATE OF CONNECTICUT

Senator WEICKER. Thank you very much, Mr. Chairman. I submit my statement for inclusion in the record in its entirety. I would like to, at this juncture, make the following brief remarks.

First of all, the fact that there still is a Small Business Administration is due, almost totally to the members, Democrat and Republican, of this Committee, who fought to maintain the Administration, sought to preserve those programs that should work, and sought to cut back those that would not. Indeed, it is a stronger SBA, maybe not in terms of actual activity but in terms of mandate, today than it was several years ago. And that would have been impossible were it not for the very active help of everyone on the Committee, with certainly the present Chairman, leading the list.

Having said that, I do not think it was the intention of any of us that what we agreed to would be undermined, either de facto by the Administrator of the Small Business Administration, or by the Administration's budget for the Small Business Administration. And that of course is exactly what has happened. Tactically, it was obviously felt by some that Congress would prevail in the matter of preserving the Small Business Administration. That being so, a word could be given. In terms of its preservation and then de facto, the word could be broken in terms of the actual activities of that body. That is something that hopefully will come to an end soon. And secondly, as far as budgets are concerned, I do not think that we will do, through the budget process, what the Administration could not do in terms of its legislative proposal, that is, the elimination of the Agency.

So Mr. Chairman, I look forward to working with you on these and many other matters. It is still important to have a Small Business Administration, which stimulates the most important part of the economy.

One last word, and that is that I would hope that we would have before us, very shortly, the nominee to be the new Administrator of the Small Business Administration. It is my understanding that our former colleague, Senator Abdnor, is that nominee. I look forward to having him before us. I assume that Jim is going to be able to answer satisfactorily the questions that are posed to him; so let us get him on board and get him to work.

[The prepared statement of Senator Weicker follows:]

OPENING STATEMENT OF LOWELL WEICKER, JR.

AT SENATE SMALL BUSINESS COMMITTEE HEARING

ON

ADMINISTRATION'S FY 1988 BUDGET PROPOSAL FOR THE

SMALL BUSINESS ADMINISTRATION

MR. CHAIRMAN LET ME COMMEND YOU FOR CONVENING THESE HEARINGS ON THE PRESIDENT'S FISCAL YEAR 1988 BUDGET REQUEST FOR THE SMALL BUSINESS ADMINISTRATION. LET ME ALSO STATE AT THE OUTSET THAT WITHOUT YOUR SUPPORT AS THE RANKING MINORITY MEMBER OVER THE PAST TWO YEARS, MY EFFORTS TO MAINTAIN AN INDEPENDENT SBA WOULD HAVE BEEN MUCH MORE DIFFICULT. I LOOK FORWARD TO CONTINUING TO WORK WITH YOU IN A BIPARTISAN FASHION DURING THE 100TH CONGRESS TO MAKE THE SBA AND ITS PROGRAMS RESPONSIVE TO THE NEEDS OF THE NATION'S SMALL BUSINESSES. THESE HEARINGS WILL HELP US TO BEGIN THAT PROCESS.

THE PRESIDENT'S BUDGET PROPOSAL FOR FY 88 DOES NOT PROPOSE THE OUTRIGHT ELIMINATION OF SBA AND ITS CREDIT ASSISTANCE PROGRAMS, BUT IT REVIVES MANY OF THE SAME OLD IDEAS THAT WE HAVE CONSIDERED IN THE PAST TWO YEARS AND REJECTED. LESS THAN A YEAR AGO, IN APRIL 1986, THE PRESIDENT SIGNED PUBLIC LAW 99-272, THE CONSOLIDATED OMNIBUS BUDGET RECONCILIATION ACT OF 1985. TITLE XVIII OF THE LAW PROVIDED A THREE-YEAR AUTHORIZATION FOR SBA THROUGH FY 1988. SOME PROGRAMS WERE ELIMINATED AND SEVERAL WERE MODIFIED AND REDUCED. THE INK HAS BARELY DRIED ON THE LAW. FULL IMPLEMENTATION OF SOME CHANGES HAVE JUST STARTED, AND NOW THE PRESIDENT'S BUDGET WOULD MAKE FURTHER CHANGES THAT GO WELL BEYOND

THE LAW. IT WOULD ELIMINATE VITAL LOAN PROGRAMS AND IMPOSE NEW AND ADDITIONAL USER FEES IN ORDER TO MAKE GUARANTEE LOAN PROGRAMS MORE "SELF-SUPPORTING".

FOR EXAMPLE, IN PUBLIC LAW 99-272 WE PRESERVED A SMALL AMOUNT OF DIRECT LOANS FOR THE HANDICAPPED, VETERANS AND MINORITIES. HISTORICALLY, THE DEMAND FOR THESE PROGRAMS HAS BEEN GREAT; EACH QUARTER FUNDS ALLOTED FOR THESE PROGRAMS HAVE BEEN COMMITTED BEFORE THE END OF THE QUARTER. YET, THE ADMINISTRATION'S PROPOSAL WOULD ELIMINATE THESE IMPORTANT LOAN PROGRAMS, AND WOULD REDUCE THE DIRECT FUNDING FOR THE MINORITY ENTERPRISE SMALL BUSINESS INVESTMENT COMPANY PROGRAM BY ALMOST FIFTY PERCENT. THE ADMINISTRATION ARGUES THAT THESE BORROWERS COULD OBTAIN GUARANTEED LOANS OR BANK FINANCING. AT THE SAME TIME THEY PROPOSE ADDITIONAL FEES FOR MOST OF THE GUARANTEE LOAN PROGRAMS.

MR. CHAIRMAN, AS WE ALL WELL KNOW, THIS COMMITTEE STUDIED THOROUGHLY WAYS TO REDUCE THE COSTS OF THE GUARANTEED LOAN PROGRAM. IN CONFERENCE ON PUBLIC LAW 99-272, WE AGREED TO INCREASE FEES IN THE 7(A) GUARANTEED LOAN PROGRAM FROM ONE TO TWO PERCENT AND TO REDUCE THE PERCENTAGE OF THE GUARANTY FROM 90 TO 85 PERCENT FOR LOANS OVER $155,000. THIS WAS DONE AFTER HEARINGS AND CLOSE EXAMINATION REVEALED THAT TO GO BEYOND THESE LEVELS WOULD MAKE THE PROGRAM USELESS TO THE BORROWERS AND THE LENDERS. NOW THE ADMINISTRATION PROPOSES REDUCING THE GUARANTY TO 75 PERCENT DOUBLING THE STATUTORY FEE FROM TWO PERCENT TO FOUR PERCENT, PURPORTEDLY, BY CHARGING THE LENDER AND THE BORROWER EACH AN ADDITIONAL POINT. WE WILL HEAR AGAIN TODAY HOW THESE PROPOSALS WILL

KILL THE PROGRAM. ADDITIONAL FEES WOULD BE IMPOSED ALSO FOR THE 502 AND 503 DEVELOPMENT COMPANY, SURETY BOND GUARANTY AND SMALL BUSINESS INVESTMENT COMPANY PROGRAMS.

THERE ARE SEVERAL OTHER ASPECTS OF WHICH WE MUST CONSIDER CLOSELY, AS WELL. THESE INCLUDE TO MENTION A FEW: ELIMINATION OF THE SBDC PROGRAM; TRANSFER OF MBDA, IN THE DEPARTMENT OF COMMERCE, TO SBA; AND, LOAN ASSET SALES WHICH APPARENTLY, SBA PLANS TO DO DURING FISCAL YEAR 1987, EVEN THOUGH THE LAW DOES NOT REQUIRE IT.

AS I SEE IT THE REAL DRIVING FORCE IN THIS BUDGET PROPOSAL IS REDUCING COSTS. NO ATTENTION IS GIVEN TO THE IMPACT OF THESE PROPOSALS ON THE PROGRAMS OR THE SMALL BUSINESSES WHO BENEFIT FROM THEM. IT IS LACED WITH THE SAME OLD PHILOSPHICAL BIASES AGAINST SBA PROGRAMS THAT WE'VE HEARD IN THE PAST TWO YEARS.

MR. CHAIRMAN, THE SMALL BUSINESS ADMINISTRATION'S SURVIVAL AS AN INDEPENDENT AGENCY IS NO LONGER IN QUESTION, HOWEVER, I DON'T BELIEVE THE AGENCY WILL BE BACK ON AN EVEN KEEL UNTIL A PERMANENT ADMINISTRATOR IS IN PLACE. THESE HEARINGS ARE IMPORTANT BECAUSE THEY PROVIDE AN OPPORTUNITY TO EXAMINE THE AGENCY'S RESOURCES AND THE ADMINISTRATION'S PROPOSALS AT THIS TIME. BUT IT IS JUST AS IMPORTANT TO PLACE AT THE HELM OF SBA SOMEONE WHO IS COMMITTED TO STRENGTHENING AND PROMOTING ITS PROGRAMS. I LOOK FORWARD TO THE DAY WHEN THE PRESIDENT SUBMITS THE NAME OF A CANDIDATE TO THE SENATE AND THE COMMITTEE HOLDS NOMINATION HEARINGS

FOR THE NEW SBA ADMINISTRATOR. THAT WILL CLEARLY SIGNAL A REAL CHANGE.

The CHAIRMAN. Thank you. Now, Senator Sasser.

STATEMENT OF HON. JAMES R. SASSER, A U.S. SENATOR FROM THE STATE OF TENNESSEE

Senator SASSER. Thank you. I simply want to echo the remarks made by our Chairman here this afternoon, and by our distinguished ranking member. I must say that I am amazed at how little has changed at the Small Business Administration. It has been over 6 months since the Administration promised to nominate a permanent Administrator for the Agency. We still have not received that nomination. And we are left to deal with the Deputy Administrator, who has made his lack of affection for the Agency well known.

Now we do not see any backing off of proposals to kill the Small Business Administration, despite clear Congressional intent that the Agency remain open. Rather, I think we see the assault on the Small Business Administration this year as being under a new guise, rather than a straightforward proposal to shift the Agency's responsibilities to another department. We see a more insidious attack. We see a proposed increase on the guarantee fee for 7(a) loans, from the current 2 percent to 4 percent. We see a phase down in the guarantee level from 85 percent on the large loans, and 90 percent on smaller loans, to 75 percent on all loans. And the guarantee on Small Business Investment Debentures would be reduced from 100 percent to 90 percent. So we are seeing, I think, steps to perhaps hamstring or kill the Small Business Administration through changes and regulations.

The Chairman referred a moment ago to selling off $1 billion of the SBA's loan assets for an estimated $140 million, 14 percent return on those assets. This is all part of the Administration's hocus pocus to try to get down to the 180 percent, or $108 billion requirements under the Gramm-Rudman-Hollings procedure. It appears to me too penny-wise and pound-foolish to sell off $1 billion worth of assets for $140 million. So what we are seeing is an attempt to kill the SBA, through various and sundry subterfuges, and we are seeing the Administration's or the Agency's programs altered so as to make them so unpalatable that no reasonable business person would wish to make use of them.

Mr. Chairman, I have an additional statement which I will ask be included in the record, if you have no objection.

The CHAIRMAN. Without objection.

[The prepared statement of Senator Sasser follows:]

STATEMENT OF SENATOR SASSER

MR. CHAIRMAN, AS WE ENTER THE 100TH CONGRESS, I AM AMAZED AT HOW LITTLE HAS CHANGED AT THE SMALL BUSINESS ADMINISTRATION. IT'S BEEN OVER SIX MONTHS SINCE THE ADMINISTRATION PROMISED TO NOMINATE A PERMANENT ADMINISTRATOR FOR THE AGENCY. WE STILL HAVEN'T RECEIVED THAT NOMINATION AND ARE LEFT TO DEAL WITH THE SAME DEPUTY ADMINISTRATOR WHO HAS MADE HIS DISDAIN FOR THE AGENCY WELL KNOWN.

NOR DO WE SEE ANY BACKING OFF OF PROPOSALS TO KILL THE SBA, DESPITE CLEAR CONGRESSIONAL INTENT THAT THE AGENCY REMAIN OPEN. NOW, I MUST ADMIT THE ASSAULT ON THE SBA THIS YEAR IS UNDER A NEW GUISE.

RATHER THAN A STRAIGHT-FORWARD PROPOSAL TO SHIFT THE AGENCY'S REPONSIBILITIES TO ANOTHER DEPARTMENT, WE SEE A MORE INSIDIOUS ATTACK. WE SEE A PROPOSED INCREASE IN THE GUARANTY FEE FOR 7(A) LOANS FROM THE CURRENT 2% TO 4%. WE SEE A PHASE-DOWN IN THE GUARANTY LEVEL FROM 85% ON LARGE LOANS AND 90% ON SMALLER

LOANS TO 75% FOR ALL LOANS. THE GUARANTY ON SMALL BUSINESS INVESTMENT COMPANY DEBENTURES WOULD BE REDUCED FROM 100% TO 90%. AND THIS IS JUST THE TIP OF THE ICEBERG.

THE ADMINISTRATION PROPOSES USER FEES ON A WIDE VARIETY OF SMALL BUSINESS PROGRAMS. FOR EXAMPLE, THE SCORE PROGRAM, A VOLUNTEER PROGRAM INVOLVING RETIRED BUSINESS PERSONS WOULD BEGIN CHARGING FOR THE TRAINING PROVIDED THROUGH THE PROGRAM.

WE SEE A PROPOSAL TO SELL OFF THE AGENCY'S LOAN PORTFOLIO AT FIRE SALE PRICES. SOME $1 BILLION IN BUSINESS LOANS WOULD BE SOLD FOR AN ESTIMATED $140 MILLION, A 14% RETURN.

WHAT THESE STEPS AMOUNT TO IS AN EFFORT TO KILL THE SBA THROUGH REGULATION. THE ACTING ADMINISTRATOR PROPOSES ALTERING THE AGENCY'S PROGRAMS TO MAKE THEM SO UNPALATABLE THAT NO REASONABLE BUSINESS PERSON WOULD MAKE USE OF THEM. THE LOWERED GUARANTEE RATES AND INCREASED FEES VIRTUALLY ASSURES DECREASED PARTICIPATION IN LOAN PROGRAMS. THE IMPOSITION OF USER

FEES WILL INHIBIT THE USE OF BUSINESS DEVELOPMENT PROGRAMS OPERATED BY THE SBA. THE SALE OF ASSETS AT FIRE SALE PRICES UNDERMINES THE AGENCY'S FISCAL STANDING.

IN SHORT, MR. CHAIRMAN, WE ARE SEEING THE SAME SONG PLAYED TO A DIFFERENT TUNE. THIS BUDGET PROPOSAL RAISES MANY SERIOUS QUESTIONS ABOUT THE FUTURE OF THE SBA. AND HOPEFULLY, WE WILL ONE DAY SOON HAVE A PERMANENT ADMINISTRATOR BEFORE US WHO CAN SHED SOME LIGHT ON WHY THE ADMINISTRATION REMAINS INTENT ON GUTTING THE SBA. UNTIL THAT TIME WE WILL CONTINUE TO LOCK HORNS WITH THE ACTING ADMINISTRATOR AND TO HOLD THE LINE AGAINST EFFORTS TO SHUT THE ONLY AGENCY IN THE FEDERAL GOVERNMENT DEVOTED EXCLUSIVELY TO AMERICA'S SMALL BUSINESS COMMUNITY.

The CHAIRMAN. Before we receive the statements from the Senators, we have one piece of business to take care of. We now have a quorum. The piece of business is simply this. In the past we had our rule that requires seven Senators to take up a bill and start marking it up even though it requires a quorum to report it out. We would like to reduce that to six, so that we can expedite the business of the Committee a little faster. Since we have a quorum here, if there is any discussion on that, I think this has been agreed to by most members in private with their staffs and so on. But if you have any questions about it, I will be glad to try to answer them. But the motion would be by the Chairman to reduce from seven to six the number considered to be a working quorum for the purposes of marking up legislation. And the remaining requirement of a full quorum of ten Senators required to report the bill out. Do I hear a second to that?

Senator WEICKER. I second it.

The CHAIRMAN. If there is no objection. Let me add to that motion that we adopt the remaining rules that we have lived under, that we lived under last year and the preceding year. Most of you I assume are very familiar with all of those. Without objection, the rule change as stated will be adopted. Senator Wallop.

STATEMENT OF HON. MALCOLM WALLOP, A U.S. SENATOR FROM THE STATE OF WYOMING

Senator WALLOP. Thank you, Mr. Chairman. This being my first meeting on the Small Business Administration, or the Small Business Committee, I guess maybe that is a freudian slip of the tongue, but let me just say how happy I am to be here.

My State is a small business State. Of the 12,000 commercial enterprises in Wyoming, 10,000 of them employ less than 20 people. So we know what small business is all about. And we know it to be more than the Small Business Administration. I think one of the things that we have to look over here, and one of the reasons I am so anxious to be on this Committee, is to provide support for the Small Business Administration, but more importantly, to provide support for small business. A whole lot of them go through life without ever touching the programs or events organized under the Small Business Administration.

In that line, one thing which I think we have to be careful about is those businesses for whom we do provide support through the programs of the Small Business Administration ought not to be unfairly subsidized over those businesses which compete with them without being a part of those programs.

A great many people in this world find themselves conducting good and ordinary and competent businesses in the community or an area of a state only to find that somehow or another somebody arrives with support from the U.S. Government in direct competition with they who have generated their position in the economy through free enterprise. My guess is that is not what we are all about. But my certainty is that is sometimes what we do. And so one of the reasons that I hope to be an active participant in the affairs and the programs of this Committee is to see to it that this Committee and this Administration and this Government, to the

extent that we can, stand for small businesses in their entirely, and not just a few small businesses who fall within a program. However well meaning, it is sometimes very unfair to those who have found their way through the free enterprise systems. I look forward to working with you.

The CHAIRMAN. Thank you, Senator Wallop. One other point if you will indulge me just a moment. I have two proxies on the rule change from Senators Baucus and Kerry. And without objection I will vote those now in favor of the rule change, and also state that we will leave the record open until 6 p.m. this evening if there are Senators who wish to be voted, they may.

Senator WEICKER. Mr. Chairman, I have proxies from Senators Rudman, Kasten, Pressler, D'Amato, and Boschwitz.

The CHAIRMAN. Those proxies will be received. There is somebody missing. Whoever that person is that is missing, if they would like to cast a vote before 6 p.m.

[The prepared statements of Senators D'Amato and Pressler follow:]

STATEMENT BY SENATOR ALFONSE M. D'AMATO
SENATE COMMITTEE ON SMALL BUSINESS
FEBRUARY 24, 1987

MR. CHAIRMAN, I WANT TO WELCOME OUR DISTINGUISHED PANEL OF WITNESSES TO THE SMALL BUSINESS COMMITTEE THIS AFTERNOON TO DISCUSS THE PRESIDENT'S PROPOSED BUDGET FOR FISCAL YEAR 1988. I ALSO UNDERSTAND THAT THE WHITE HOUSE WILL SHORTLY SEND TO THE SENATE ITS NOMINATION FOR ADMINISTRATOR OF THE SMALL BUSINESS ADMINISTRATION, OUR FORMER COLLEAGUE FROM SOUTH DAKOTA, SENATOR JAMES ABDNOR. IN MY OPINION, SENATOR ABDNOR WILL BE A STRONG ADVOCATE FOR ALL SMALL BUSINESS PEOPLE THROUGHOUT THE UNITED STATES.

THE IMPORTANCE OF SMALL BUSINESS IN THIS NATION CANNOT BE UNDERSTATED. A FEW FACTS ILLUSTRATE THIS POINT:

* SMALL BUSINESS EMPLOYS 48% OF THE U.S. WORKFORCE;
* THESE FIRMS PRODUCE 38% OF OUR GNP;
* MORE THAN 700,000 PERSONS WILL START A SMALL BUSINESS THIS YEAR;
* SMALL BUSINESS ACCOUNTS FOR MORE THAN 60% OF ALL NEW JOBS.

AS WE FIGHT TO REDUCE OUR SPIRALLING TRADE DEFICIT WHICH EXCEEDS $170 BILLION, WE MUST ENCOURAGE AMERICANS GIFTED WITH ENTREPRENEURIAL SKILLS AND GOOD AMERICAN KNOW-HOW. THESE ARE THE

PEOPLE WHO WILL KEEP THE U.S. COMPETITIVE IN THE WORLD MARKET-PLACE. THEY ARE THE REASON FOR THE VERY EXISTENCE OF THE SMALL BUSINESS ADMINISTRATION.

RECENTLY, THE NATIONAL COMMISSION ON JOBS AND SMALL BUSINESS RELEASED ITS REPORT ON JOB DEVELOPMENT. SPECIFICALLY, THE COMMISSION FOCUSED ON SMALL BUSINESS ACCESS TO CAPITAL, TECHNOLOGY, AND RESEARCH AND DEVELOPMENT. ONE PROBLEM AREA THE COMMISSION NOTED WAS THAT THE FEDERAL AND STATE GOVERNMENTS DO FAR TOO LITTLE TO ENCOURAGE SMALL BUSINESS TO BECOME EXPORTERS. IT IS MY HOPE THAT WE WILL LEND MORE TECHNICAL AND FINANCIAL ASSISTANCE TO SMALL BUSINESS SO THAT THEY WILL HAVE AS LARGE AN IMPACT IN THE INTERNATIONAL MARKET AS THEY DO IN THE DOMESTIC MARKET.

MR. CHAIRMAN, I LOOK FORWARD TO THE TESTIMONY THAT WILL BE PRESENTED THIS AFTERNOON AND HOPE THAT OUR WITNESSES WILL ADDRESS SOME OF THE ISSUES I HAVE TOUCHED UPON.

OPENING STATEMENT OF SENATOR LARRY PRESSLER
BEFORE THE COMMITTEE ON SMALL BUSINESS
HEARING ON ADMINISTRATION'S FY 1988 BUDGET PROPOSAL
FOR THE SMALL BUSINESS ADMINISTRATION
FEBRUARY 24, 1987

I WANT TO BEGIN THIS AFTERNOON BY CONGRATULATING THIS COMMITTEE'S NEW CHAIRMAN, SENATOR BUMPERS. I LOOK FORWARD TO WORKING UNDER HIS ABLE LEADERSHIP DURING THE 100TH CONGRESS.

IT IS ALSO A PLEASURE TO BEGIN THIS YEAR'S DELIBERATIONS ON THE SMALL BUSINESS ADMINISTRATION'S BUDGET WITH AN ADMINISTRATION PROPOSAL WHICH CALLS FOR RETAINING THE INDEPENDENT STATUS OF THE AGENCY. I BELIEVE THIS PROPOSAL GIVES THIS COMMITTEE SOME FOOD FOR THOUGHT.

FOR INSTANCE, I LIKE THE FACT THAT THE PROPOSAL EXPANDS THE SBA'S SURETY BOND PROGRAM. WHEN THIS PROGRAM RAN OUT OF AUTHORITY SHORTLY BEFORE THE END OF THE LAST FISCAL YEAR, IT CAUSED SOME RATHER SERIOUS PROBLEMS IN MY HOME STATE OF SOUTH DAKOTA. I UNDERSTAND THAT SIMILAR PROBLEMS OCCURRED IN MANY OTHER STATES AS WELL.

I AM ALSO PLEASED TO NOTE THAT THE FRAMEWORK FOR THIS PROPOSAL CAME FROM MY HOME STATE COLLEAGUE, SENATOR JIM ABDNOR. LET ME TAKE THIS OPPORTUNITY TO NOTE HOW PROUD I AM THAT SENATOR ABDNOR WILL SOON BE NOMINATED TO BE THE NEXT ADMINISTRATOR OF THE SBA. I AM CERTAIN JIM WILL SERVE WITH DISTINCTION AND THAT IT WILL BE A PLEASURE TO WORK WITH HIM.

WHILE I AM PLEASED WITH THESE DEVELOPMENTS, THEY ARE NOT, OF COURSE, WHY WE ARE HERE TODAY. IN THIS TIME OF INCREASING INTEREST IN BALANCING THIS NATION'S BUDGET, EVERY EXPENDITURE OF FEDERAL MONEY MUST BE CAREFULLY SCRUTINIZED. AT THE SAME TIME, IF WE ARE TO

SELL GOVERNMENT LOAN ASSETS IN AN EFFORT TO LOWER DEFICITS, WE MUST LOOK NOT ONLY TO SHORT TERM GAINS. AT THE VERY LEAST, WE MUST ENSURE WE RECEIVE A FAIR RETURN ON THESE SALES.

THIS BRINGS ME TO THE ADMINISTRATION'S PROPOSAL TO SELL APPROXIMATELY $1.5 BILLION OF GENERAL BUSINESS AND DEVELOPMENT COMPANY LOANS AND ROUGHLY $800 MILLION OF DISASTER LOANS. ONE PART OF THIS PLAN WHICH CONTINUES TO TROUBLE ME IS THAT THE ADMINISTRATION INSISTS ON SELLING THESE LOAN PORTFOLIOS WITHOUT RECOURSE. THIS TYPE OF SALE SUBSTANTIALLY REDUCES THE GOVERNMENT'S RATE OF RETURN. MORE IMPORTANTLY, IT MAY PUT THOSE WHO HAVE TAKEN OUT SUCH LOANS IN AN UNFAIR POSITION.

LAST FALL, THERE WAS A FIRE IN REDFIELD, SOUTH DAKOTA WHICH DEVASTATED MUCH OF THE COMMUNITY'S MAIN STREET. THIS IS A TOWN ALREADY HURT BY THE POOR FARM ECONOMY. MONEY IS TIGHT. THE CITY TURNED TO THE SBA FOR HELP AND AS WE SIT HERE TODAY, SBA PERSONNEL ARE IN REDFIELD HELPING BUSINESS AND HOME OWNERS FILE DISASTER LOAN APPLICATIONS. SHOULD THE FEDERAL GOVERNMENT GUARANTEE THESE INDIVIDUALS LOANS AND THEN TURN AROUND SOME YEARS LATER AND REMOVE THIS GUARANTEE? LAST YEAR, CONGRESS APPROVED THE SALE OF SOME LOANS. HOW SUCCESSFUL THE PLAN WILL BE REMAINS TO BE SEEN. BEFORE WE GO MUCH FURTHER DOWN THIS PATH, THESE BLANKS SHOULD BE FILLED IN.

ONCE AGAIN THIS YEAR, THE ADMINISTRATION HAS PROPOSED AN INCREASE IN THE GUARANTY FEE FOR 7(A) LOANS. AT THE SAME TIME THE AMOUNT OF GUARANTEE OFFERED BY THE GOVERNMENT WOULD BE LOWERED. THIS, OF COURSE, IS NOT A NEW IDEA. HOWEVER, ONCE AGAIN THIS YEAR WE MUST DECIDE HOW BEST TO HANDLE IT. I KNOW A NUMBER OF THE WITNESSES WILL BE ADDRESSING THIS ISSUE TODAY.

ANOTHER PART OF THE PROPOSAL WHICH I HOPE WILL RECEIVE CAREFUL REVIEW BY THIS COMMITTEE IS THE PHASING OUT OF FUNDING FOR THE SMALL BUSINESS DEVELOPMENT CENTERS PROGRAM OVER THE NEXT FIVE YEARS. I CANNOT SPEAK FOR OTHER STATES, BUT SOUTH DAKOTA'S SBDC HAS JUST BEGUN TO TAKE OFF. I AM VERY MUCH IMPRESSED WITH WHAT I HAVE SEEN. I WOULD LIKE TO EXPLORE THIS AREA OF THE SBA BUDGET PLAN MORE EXTENSIVELY.

IN ADDITION, THE ADMINISTRATION HAS PROPOSED SIGNIFICANT CHANGES IN BOTH THE GUARANTEED AND DIRECT LOAN PROGRAMS FOR VETERANS, MINORITIES AND THE HANDICAPPED. I AM CERTAIN WE WILL BE HEARING QUITE A BIT ABOUT THESE IDEAS TODAY AND I LOOK FORWARD TO RECEIVING THE TESTIMONY OF ALL WITNESSES.

DURING THE 99TH CONGRESS, THIS COMMITTEE AND THE CONGRESS, IN A TRULY BIPARTISAN EFFORT, DEVELOPED A COMPROMISE WHICH DRASTICALLY REALIGNED THE PRIORITIES OF THE SBA. IN THE END, A STREAMLINED AGENCY, ONE BEFITTING OUR ECONOMIC SITUATION, WAS CREATED. THE ADMINISTRATION HAS NOW PROPOSED WHAT AMOUNTS TO ANOTHER SIGNIFICANT REALIGNMENT OF THE SBA.

THESE ARE ALL THINGS WE MUST CONSIDER AS WE BEGIN THE TASK OF DEVELOPING AN SBA BUDGET FOR THE COMING YEAR. GIVEN THE CONTINUED CONSTRAINTS OF BUDGET DEFICITS, OUR JOB HAS NOT GOTTEN ANY EASIER. I LOOK FORWARD TO WORKING WITH OUR NEW CHAIRMAN AND ALL MEMBERS OF THE COMMITTEE IN DEVELOPING A BUDGET WHICH WILL ALLOW THE SBA TO CONTINUE AND IMPROVE ITS SERVICE TO THIS NATION'S SMALL BUSINESS COMMUNITY.

The CHAIRMAN. Senator Dixon.

STATEMENT OF HON. ALAN J. DIXON, A U.S. SENATOR FROM THE STATE OF ILLINOIS

Senator DIXON. Mr. Chairman, the Administration's proposed budget for the Small Business Administration for fiscal year 1988 shows some improvement over prior year's recommendations in that it continues the existence of the SBA as an independent agency, and it funds most of the programs at the 1987 levels.

My concerns however, surround the recommendations for reducing costs by the elimination of Direct Loans to the Handicapped and the Veterans, reduction of Direct Loans to Minority Enterprise Small Business Investment Companies, and the increase in General Business Guarantee Fees. Additionally, I question the ability of the SBA to absorb the Minority Business Development Administration, currently in the Commerce Department.

Lastly, I am interested in the logic behind the Administration's recommendation to phase out the funding for the Small Business Development Centers. In 1985 alone, these centers counseled approximately 12,200 small business owners in Illinois, through general information and long term and short term counseling. Approximately 700 programs were held in my state, with about 17,525 attendees. These services are obviously of need and are put to good use in my State, Mr. Chairman.

We have an oversight obligation for the SBA and I recognize that all programs cannot be funded but neither can we agree to the reductions in the fiscal year 1988 SBA budget as proposed by the Administration. We must establish priorities here and in our subcommittee that best meet the needs of the small business community.

I ask that the balance of my remarks be reintroduced in the Committees.

The CHAIRMAN. Without objection.

[The prepared statement of Senator Dixon follows:]

FEBRUARY 24, 1987

STATEMENT BY SENATOR ALAN J. DIXON

COMMITTE ON SMALL BUSINESS

HEARING ON THE BUDGET PROPOSAL FOR THE SBA

MR. CHAIRMAN, THE ADMINSTRATION'S PROPOSED BUDGET FOR THE SMALL BUSINESS ADMINSTRATION FOR FISCAL YEAR 1988 SHOWS SOME IMPROVEMENT OVER PRIOR YEAR'S RECOMMENDATIONS IN THAT IT CONTINUES THE EXISTENCE OF THE SBA AS AN INDEPENDENT AGENCY AND FUNDS MOST PROGRAMS AT 1987 LEVELS.

MY CONCERNS, HOWEVER, SURROUND THE RECOMMENDATIONS FOR REDUCING COSTS BY THE ELIMINATION OF DIRECT LOANS TO THE HANDICAPPED AND THE VETERANS; THE REDUCTION OF DIRECT LOANS TO MINORITY ENTERPRISE SMALL BUSINESS INVESTMENT COMPANIES (MESBICs); AND THE INCREASE IN GENERAL BUSINESS GUARANTEE FEES.

ADDITIONALLY, I QUESTION THE ABILITY OF THE SBA TO ABSORB THE MINORITY BUSINESS DEVELOPMENT ADMINISTRATION CURRENTLY UNDER THE COMMERCE DEPARTMENT.

LASTLY, I AM INTERESTED IN THE LOGIC BEHIND THE ADMINISTRATION'S RECOMMENDATION TO PHASE OUT THE FUNDING FOR THE SMALL BUSINESS DEVELOPMENT CENTERS. IN 1985, THESE CENTERS COUNSELED APPROXIMATELY 12,200 SMALL BUSINESS OWNERS IN ILLINOIS THROUGH GENERAL INFORMATION AND SHORT TERM AND LONG TERM COUNSELING. APPROXIMATELY 700 PROGRAMS WERE HELD WITH ABOUT 17,525 ATTENDEES. THESE SERVICES ARE OBVIOUSLY OF NEED AND USE IN ILLINOIS.

MR. CHAIRMAN, WE HAVE AN OVERSIGHT OBLIGATION FOR THE SBA AND I RECOGNIZE THAT ALL PROGRAMS CANNOT BE FUNDED BUT NEITHER CAN WE AGREE TO THE REDUCTIONS IN THE FY 88 SBA BUDGET AS PROPOSED BY THE ADMINISTRATION. WE MUST ESTABLISH PRIORITIES HERE AND IN OUR SUBCOMMITTEES THAT BEST MEET THE NEEDS OF THE SMALL BUSINESS COMMUNITY.

I HAVE SEVERAL QUESTIONS DEALING WITH THE PARTICULARS OF THE AREAS I HAVE RAISED THAT I WILL ASK LATER IN THE HEARING.

The CHAIRMAN. Senator Bond.

STATEMENT OF HON. CHRISTOPHER BOND, A U.S. SENATOR FROM THE STATE OF MISSOURI

Senator BOND. Thank you Mr. Chairman. It is my pleasure to join you, the ranking Member and the other Members of this Committee.

This, too, is my first meeting of the Small Business Committee. And I recognize, as we all do, in this time of fiscal constraints, it is essential that we examine all governmental programs, to ensure that we are spending money efficiently, effectively, and that we make savings wherever possible. I look forward to working with this Committee to ensure that we carry out that objective within the parameters of providing the kind of support and assistance that the small business communities in our states need.

Mr. Chairman, you and I, and Senator Boren share a common background, coming from State governments where we have worked with small business, and it has been one of the most important things that we could do for our States in recent years. In Missouri we have established a one stop shop for small businesses to get information from State governments, and get assistance at that level.

In addition, one program which we used in cooperation with the Federal Government was extremely important in assisting our small businesses in Missouri to expand their exports. We established, with the cooperation of the Department of Commerce, a computerized hot-line which brought in trade leads from our embassies and consulates all over the world. These leads were provided in a very timely basis to small businesses in our State. I believe that the demonstrated effectiveness of this program, in cooperation with State governments, is a model for future activities in the years to come.

I look forward to working with you, Mr. Chairman, and the other members of this Committee on what is an area of great importance to the men and women in my State and in your States as well. Thank you.

The CHAIRMAN. Thank you, Senator Bond. I also want to say that we are very pleased to have you and Senator Wallop and Senator Mikulski all join this Committee. I think there are three new members on this Committee, are there not? I will tell you we are all highly honored to have you with us.

Now, Senator Levin.

STATEMENT OF HON. CARL LEVIN, A U.S. SENATOR FROM THE STATE OF MICHIGAN

Senator LEVIN. Mr. Chairman, just briefly, as you and the ranking member have recounted, this Committee on a bipartisan basis and in prior years have turned back efforts on the part of the Administration to dismantle the Small Business Administration directly. That frontal assault was turned back both by the Senate and by the House. That also protected it, and I am very confident that we are not going to permit the Administration or anyone else to do indirectly what they failed to do directly. To do through the

back door what they could not do walking through the front door. And many of these budget requests would constitute the indirect or effective dismantlement of an agency, which I believe plays an important role, which this Committee again, in a bipartisan basis has supported in prior years, and I am looking forward to working with both you Mr. Chairman, the ranking members, our old members and our new members in making sure that the programs of the SBA that work continue to work, and are not indirectly dismantled.

The CHAIRMAN. Thank you. Senator Harkin.

STATEMENT OF HON. TOM HARKIN, A U.S. SENATOR FROM THE STATE OF IOWA

Senator HARKIN. Thank you Mr. Chairman. First of all, I want to pay a public tribute to the distinguished Senator from Connecticut, our colleague for his stewardship of this Committee the last several years prior to this year. I think that he was more than kind in saying that it was this Committee that was instrumental in saving the Small Business Administration, when in fact, it was Senator Weicker who provided the prodding and the pushing and the leadership on this Committee to maintain that Small Business Administration. So I publicly want to thank Senator Weicker for his strong leadership in this Committee over the last several years.

And again, also say that I am just as pleased as punch that our new Chairman has at least an equal interest in and support of small business. So I am assured that this Committee will continue on in the fine tradition, and with the same level of interest, and support for small business that was set by Senator Weicker.

I am greatly interested in the small business aspect of competition and anti-trust. Mr. Chairman, I hope to use that subcommittee to take a look at some of the continuing anti-trust violations in this country, and how they are affecting small businesses, and how we might be able to address that, either in this Committee or in other Committees of the Congress.

Second, as Chairman of the Handicap Subcommittee on the Labor and Human Resources Committee, I am greatly disturbed by the proposal by the Administration to zero out the Handicapped Assistance Loan Program that Senator Dixon spoke about in his opening comments. Just for the record, I point out, Mr. Chairman that we went from a high of, I am just saying in fiscal year 1985 we had 253 loans for $24.4 million. That was down last year to 135 loans and $15 million. And for the first quarter of 1987, only 17 loans have been made for $1.7 million. So even though this Committee has said in the past that we want to continue this program, it looks as though de facto they are trying to zero it out just by not making the loans. And Mr. Chairman I assure you at least that this Senator, I am sure others here will be interested in making sure that the Small Business Administration meets its responsibilities. And needs the direct guidance and direct input of this Committee in making sure that the Handicap Program continues unabated, as it has in the past. Thank you.

The CHAIRMAN. Thank you. Senator Boren.

STATEMENT OF HON. DAVID L. BOREN, A U.S. SENATOR FROM THE STATE OF OKLAHOMA

Senator BOREN. Thank you. I want to join with the others in the comments that have been made about you and your immediate predecessor. The small business community of this country I think is very fortunate indeed that the leadership of this Committee has been in such able hands and continues to be in able hands. And I want to commend you for your prompt scheduling of these budget oversight hearings.

I am heartened to see that the Administration has proposed to keep the SBA as a separate, independent agency. But I want to echo the concerns that have been made by several of my colleagues, that we must make certain that we do not do by indirection what has not happened by direct action. We must not undermine the effectiveness and programs of the Agency through the budgetary process, while purporting to keep it as a strong and independent Agency.

I continue to have concern that the Administration's fascination with asset sales might lead us into unwise activities that would deny us of an income stream down the line, and might result in fire sale prices for our loan portfolio. I am concerned as well with the proposed implementation of user fees on programs concerned with business development and procurement assistance. I have been trying to work in my state to try to help the private sector, small businesses in particular, become more involved with Government procurement. This is a very technical area. I think for us to charge user fees to those firms that have no guarantee that they will ever have any resulting contracts, certainly will discourage participation in those programs.

I join with Senator Dixon in expressing concern about the phasing out of funding for the Small Business Development Centers, which has certainly been beneficial in many areas. And also, in expressing concern about the proposal to eliminate $77 million in Direct Loan Funds now going to the handicapped, minorities, and veterans. SBA, in states like mine that are now suffering great economic distress, continue to play a very, very important role, and I hope that we will carefully examine all of these proposals that are before us, Mr. Chairman. I will at the same time, submit the balance of my remarks for the record.

I do want to say that I am very sorry that I have another committee meeting scheduled this afternoon that I have to attend. But the Committee will be very fortunate in a few moments to hear from Mr. Tony Wilkinson, who is senior vice-president of the Stillwater National Bank, and he is responsible in that capacity for participation in SBA programs. Stillwater National is one of the largest volume lenders for SBA in our region. And Tony was the National Small Business Financial Services advocate, so recognized in 1986. He is also the executive vice-president of the National Association of Government Guaranteed Lenders. I know the testimony we will hear this afternoon will be very helpful to us in the Committee, and I apologize in advance for not being able to be a part of these precedings later on. Thank you Mr. Chairman.

The CHAIRMAN. Thank you. And I might say Tony has been before this Committee before and had a very eloquent statement, as I am sure he will again today.

[The prepared statement of Senator Boren follows:]

STATEMENT OF SENATOR BOREN

Mr. Chairman:

I commend your prompt scheduling of these budget oversight hearings for the Small Business Administration. I am heartened to see that the Administration has proposed to keep the SBA a separate independent agency. However, I am concerned with some of their specific proposals.

My biggest concern is this Administration's fascination with asset sales. Why on earth would the Federal Government want to sell $2.240 billion in loans for an estimated $643 million? Why foreclose ourselves a consistent income stream for the sake of a one time revenue gain? These firesale tactics will serve only to limit our future ability to finance small business programs. In my home state of Oklahoma, where we are faced with a record number of business closings, the SBA guaranteed loan program has been a vital source of capital for small business. Let's not unduly hinder the long-term future of these important programs by forcing a short-term outlook on the budget process.

I am concerned as well with the proposed implementation of user fees upon programs concerned with business development and procurement assistance. I have been searching for ways to involve more Oklahoma business in contracting that occurs out of the Tinker Air Logistics Center in Midwest City, Oklahoma. More than $3 billion in goods and services is contracted annually at Tinker. Less than $300 million of that business goes to Oklahoma firms. When I ask small firms why they don't pursue contracts at Tinker, I am told that the process is generally confusing. Now the

Administration is proposing that we charge firms to learn how to contract with the federal government, with no assurance whatsoever that they will even receive a contract. Somehow, I don't think that this will encourage more small firms to bid on government contracts.

If the goal of the SBA is help small business grow and develop, why then is the Administration proposing to phase out funding for small business development centers (SBDC's)? Mr. Chairman, there are not many business consultants in Durant, Oklahoma. However, because of the SBDC program should a local merchant have a problem, ranging from cash flow to inventory control, they have resources available to them at the SBDC to help resolve these problems. In Oklahoma the outreach program of the SBDC's has taken these resources into some of our smallest communities. The benefit of this program far outweighs any cost involved.

Finally Mr. Chairman, I do not understand the reasoning behind the Administration's proposal to eliminate $77 million in direct loan funds now going to the handicapped, minorities and veterans. I have already expressed my appreciation of the impact SBA financing has on distressed local economies like we are currently experiencing in Oklahoma. To end programs for the handicapped and veterans now would be extremely harmful. Substantial funding cuts have been sustained in those programs over the past several years. It is important that we keep these programs alive and well.

Thank you again Mr. Chairman for your prompt consideration of these important programs. I hope that those in leadership positions at the Small Business Administration have listened.

The CHAIRMAN. I am going to make a couple of observations. Just as a matter of procedure, it will be the practice of the Chair to recognize Senators in order of their appearance here in the Committee, alternating back and forth as we have done today. And I hope that will meet with everybody's approval, and hopefully encourage prompt attendance, so we can get going. I also have to leave for a few minutes, at which time I have asked Senator Levin if he will Chair the Committee. He has graciously agreed to do so.

Mr. Heatherly, we have been waiting anxiously to hear your testimony. You have been very indulgent to listen to us, now we are prepared to hear you.

Mr. HEATHERLY. Thank you. I have only a brief opening statement.

STATEMENT OF CHARLES L. HEATHERLY, DEPUTY ADMINISTRATOR OF THE SMALL BUSINESS ADMINISTRATION, ACCOMPANIED BY LAWRENCE ROSENBAUM, ACTING COMPTROLLER, AND EDWIN T. HOLLOWAY, ASSOCIATE ADMINISTRATOR FOR FINANCE AND INVESTMENT

Mr. HEATHERLY. It is a pleasure to come before the Committee this afternoon and discuss the President's budget proposal for fiscal year 1988, and to answer your questions. Accompanying me at the table is Lawrence Rosenbaum, our acting Comptroller on my left, and Edwin T. Holloway, the Associate Administrator for Finance and Investment, on my right.

I have submitted to the Committee my written testimony and opening statement with appendices, which I assume will be made a part of the permanent record of the hearing.

Following the President's statement last August 15, to the state Chairs of the White House Conference on Small Business, about the continuation of SBA as a strong voice in the executive branch, I immediately, that very weekend, began speaking out in public and to our Agency staff about the President's commitment to an independent SBA.

I simultaneously began earnest discussions with the Office of Management and Budget concerning our fiscal year 1988 budget and restored a traditional relationship with OMB, which had been lacking for some time.

Our proposed budget for fiscal year 1988 is a dramatic change in direction from the Administration's proposal of the 2 previous years. I believe that we are striving to maintain essential services and program levels, while simultaneously reducing total costs by applying reasonable user fees and loan fees. We do not expect universal agreement with our proposals, and we expect to hear alternative concepts in the weeks ahead. We stand ready to discuss new ideas and constructive reformulations to our user fee proposals. But we firmly believe that there is widespread support in the business community for our basic strategy which is to preserve an independent SBA, one that strives for greater self-sufficiency through reasonable fees and sound management practices.

Mr. Chairman, I and my colleagues will be pleased to answer your questions.

[The prepared statement of Mr. Heatherly follows:]

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TESTIMONY

OF

CHARLES L. HEATHERLY

ACTING ADMINISTRATOR

U.S. SMALL BUSINESS ADMINISTRATION

BEFORE THE

U.S. SENATE SMALL BUSINESS COMMITTEE

FEBRUARY 24, 1987

MR. CHAIRMAN, MEMBERS OF THE COMMITTEE, IT IS A PLEASURE TO COME BEFORE THE COMMITTEE THIS AFTERNOON TO DISCUSS THE PRESIDENT'S BUDGET PROPOSAL FOR FISCAL YEAR 1988 AND TO ANSWER YOUR QUESTIONS ON THE ADMINISTRATION OF THE AGENCY'S PROGRAMS. ACCOMPANYING ME IS LAWRENCE R. ROSENBAUM, OUR ACTING COMPTROLLER, AND EDWIN T. HOLLOWAY, ASSOCIATE ADMINISTRATOR FOR FINANCE AND INVESTMENT. I HAVE SUBMITTED TO THE COMMITTEE MY WRITTEN TESTIMONY WITH APPENDICES WHICH I REQUEST BE MADE A PART OF THE RECORD OF THIS HEARING.

BEFORE DISCUSSING THE SPECIFIC AREAS OF OUR FISCAL YEAR 1988 BUDGET PROPOSAL MENTIONED IN THE COMMITTEE'S LETTER OF INVITATION, I WOULD LIKE TO REVIEW THE OVERALL CONDITION OF THE AGENCY AND HIGHLIGHT A FEW MANAGEMENT INITIATIVES WE THINK ARE POSITIVE AND LONG OVERDUE.

FOLLOWING THE PRESIDENT'S STATEMENT LAST AUGUST 15 TO THE STATE CHAIRS OF THE WHITE HOUSE CONFERENCE ON SMALL BUSINESS ABOUT THE CONTINUATION OF SBA AS A STRONG VOICE IN THE EXECUTIVE BRANCH, I IMMEDIATELY BEGAN SPEAKING TO THE PUBLIC AND TO OUR AGENCY STAFF ABOUT THE PRESIDENT'S COMMITMENT TO AN INDEPENDENT SBA. I SIMULTANEOUSLY BEGAN DISCUSSIONS WITH THE OFFICE OF MANAGEMENT AND BUDGET CONCERNING OUR FISCAL YEAR 1988 BUDGET.

THE COMMITTEE SHOULD KNOW THAT IN JUNE OF LAST YEAR, I INITIATED CONVERSATIONS WITH WHITE HOUSE OFFICIALS ABOUT THE NEED TO MOVE FORWARD AND SELECT A NOMINEE TO FILL THE VACANT POST OF AGENCY ADMINISTRATOR.

I AM PLEASED THAT FORMER SENATOR JIM ABDNOR'S NOMINATION WILL BE FORWARDED TO THIS COMMITTEE IN A MATTER OF DAYS.

FY '87 OPERATING PLANS

LOOKING AT OUR SITUATION LAST AUGUST, I RECOGNIZED THE NEED TO RECOVER A SENSE OF MISSION -- AND A COMMITMENT TO RENEWAL AND REVITALIZATION -- AFTER TWO YEARS OF UNCERTAINTY AND CONTROVERSY.

THEREFORE, IN AUGUST I INITIATED A REINVIGORATION OF OUR ANNUAL PLANNING SYSTEM TO PUT IN PLACE A SET OF WRITTEN PROGRAM GOALS AND PRIORITIES AS GUIDELINES FOR AGENCY MANAGERS IN DEVELOPING THEIR FY '87 OPERATING PLANS.

AFTER A SERIES OF MEETINGS AMONG PROGRAM HEADS AND REGIONAL ADMINISTRATORS -- AND AN EXTENSIVE EXCHANGE OF PROPOSALS -- ON OCTOBER 15, I ISSUED A SET OF "FISCAL YEAR 1987 GOALS AND PRIORITIES." (APPENDIX I)

As Acting Administrator, I set out three general principles followed by six program initiatives. They are as follows:

I. Statutory and regulatory requirements are to be observed fully and conscientiously;

2. Service to the small business client is the touchstone for all Agency activities; and

3. Economy, efficiency, and integrity in the use of agency resources are the responsibilities of all employees.

The Agency priorities for FY '87 are:

I. Productivity improvements in all program and administrative operations;

2. Improvement of internal control systems to safeguard resources and assets against waste, fraud, and abuse;

3. Implementation of business development concepts throughout program offices to better focus available resources on demonstrated client business needs.

4. EXPANDED COOPERATION AND COORDINATION AMONG ALL SBA UNITS TO FOCUS AGENCY AND PRIVATE SECTOR RESOURCES ON IMPROVED PORTFOLIO MANAGEMENT TO ACHIEVE CONCRETE, MEASURABLE PROGRESS IN DELINQUENCIES AND DEFAULT RATES, WITH REGIONS AND DISTRICTS ESTABLISHING SPECIFIC GOALS FOUNDED ON BASELINE DATA AND UNIFIED EFFORTS;

5. COST RECOVERY IN PROGRAM ADMINISTRATION THROUGH USER FEES AND OTHER VEHICLES WHERE AUTHORIZED AND APPROPRIATE; AND

6. IMPROVED EFFECTIVENESS IN THE 8(A) PROGRAM THROUGH IMPLEMENTATION OF NEW REGULATIONS AND EMPHASIS ON PRIVATE SECTOR MARKETS.

THESE PRINCIPLES AND PRIORITIES WERE FOLLOWED BY THIRTY PAGES OF PROGRAM GOALS -- OFFICE BY OFFICE, PROGRAM BY PROGRAM -- WHICH COMPRISED THE FOUNDATION FOR SETTING GOALS IN THE REGIONAL AND DISTRICT OFFICES.

THE FINAL STEP IN THE CHAIN WAS THE TRANSLATION OF DISTRICT OPERATING PLANS INTO INDIVIDUAL PERFORMANCE PLANS FOR EACH EMPLOYEE.

FOLLOWING THE PASSAGE ON OCTOBER I7 OF OUR APPROPRIATION FOR FY '87, WE IMMEDIATELY ISSUED REVISED STAFF CEILINGS FOR EACH REGION AND EACH CENTRAL OFFICE UNIT. THE CEILINGS CALLED FOR THE HIRING OF I96 ADDITIONAL EMPLOYEES ABOVE THE SEPTEMBER 30 ON-BOARD EMPLOYMENT LEVEL. (APPENDIX II)

TWENTY-ONE OF THESE POSITIONS WERE DESIGNATED FOR THE BREAKOUT PCR PROGRAM. IN ADDITION, TEN NEW POSITIONS WERE DESIGNATED FOR A FULL-TIME VETERAN ADVOCATE IN EACH REGIONAL OFFICE.

NEW AND PROPOSED REGULATIONS

I WANT TO OFFER A FEW HIGHLIGHTS OF THE AGENCY'S PROGRAMMATIC ACHIEVEMENTS OVER THE PAST I2 MONTHS. FIRST, I AM ATTACHING A MULTI-PAGE OUTLINE OF NEW AND PROPOSED REGULATIONS IMPLEMENTED OR PROMULGATED DURING FY '86. (APPENDIX III) PRINCIPAL AMONG THESE NEW REGULATIONS WAS THE COMPREHENSIVE SET OF NEW REGULATIONS OF MINORITY SMALL BUSINESS/CAPITAL OWNERSHIP DEVELOPMENT (MSB/COD) WHICH TOOK EFFECT ON NOVEMBER 24, I986.

OTHER MAJOR REGULATIONS ISSUED DURING THIS PERIOD COVER SUCH ISSUES AS BUSINESS LOAN POLICIES, DISASTER LOANS, DEBT COLLECTION, SMALL BUSINESS INVESTMENT COMPANIES, POOLING

MECHANISMS AND IMPLEMENTATION OF NEW LEGISLATION ON SIZE STANDARDS.

SBIC AND 504 DEBENTURE POOLING

AS THE COMMITTEE WILL RECALL, ONE ISSUE RAISED IN THE HEARING OF APRIL 28, 1986, WAS THE QUESTION OF HOW THE AGENCY WOULD PROCEED WITH THE IMPLEMENTATION OF P.L. 99-272 ON THE PUBLIC SALE OF SBIC AND 504 DEBENTURES.

TWO FUNDINGS OF THE SBIC PROGRAM HAVE OCCURRED UNDER THE AUTHORITY OF PUBLIC LAW 99-272. THE FIRST SALE OF CERTIFICATES CLOSED ON SEPTEMBER 24, 1986 AND FUNDED DEBENTURES TOTALLING $67,190,000 ISSUED BY 36 LICENSEES.

THE DEBENTURES AND CERTIFICATES, WHICH CARRY SBA'S FULL FAITH AND CREDIT GUARANTEE OF TIMELY PAYMENT OF PRINCIPAL AND INTEREST, WERE FOR A TERM OF TEN YEARS AT A COUPON INTEREST RATE OF 8.75 PERCENT.

THE SECOND SALE CLOSED ON FEBRUARY 4, 1987 AND FUNDED A $49,230,000 POOL OF TWENTY-FIVE SBIC TEN-YEAR DEBENTURES AT A COUPON INTEREST RATE OF 7.95 PERCENT. THE POOLERS -- UNDERWRITERS--FOR BOTH SALES WERE CITICORP INVESTMENT BANK, THE FIRST BOSTON CORPORATION, AND GOLDMAN, SACHS & CO.

FOUR FUNDINGS OF THE 504 PROGRAM HAVE OCCURRED UNDER THE AUTHORITY OF PUBLIC LAW 99-272. THE FIRST SALE OF CERTIFICATES CLOSED ON NOVEMBER I2, I986, AND SALES HAVE CONTINUED ON A MONTHLY BASIS. ONE HUNDRED NINETY-FIVE DEBENTURES HAVE BEEN FUNDED FOR A TOTAL OF $4I.7 MILLION. THE POOLERS -- UNDERWRITERS -- FOR THESE SALES WERE MERRILL LYNCH CAPITAL MARKETS AND CITICORP INVESTMENT BANK. (APPENDIX IV)

IMPLEMENTATION OF REAUTHORIZED 8(A) PILOT PROGRAM

PUBLIC LAW 99-567 REAUTHORIZED THE 8(A) PILOT PROGRAM THROUGH SEPTEMBER 30, I988 AND REQUIRES THE PRESIDENT TO DESIGNATE A PILOT AGENCY FOR THE PROGRAM. THE AGENCY HAS RECOMMENDED TO THE PRESIDENT THAT THE DEPARTMENT OF TRANSPORTATION BE DESIGNATED AS THE PILOT AGENCY. IN EFFECT, THIS ACKNOWLEDGES THE INTENT OF THE REAUTHORIZATION THAT THE PILOT IS TO BE CONTINUED AS PART II OF THE EARLIER PILOT PROGRAM. THE AGENCY THEREFORE, FEELS THAT THE DEPARTMENT OF TRANSPORTATION IS THE MOST LOGICAL AND APPROPRIATE DESIGNATION. OTHERS IN THE ADMINISTRATION FELT THAT IT WOULD BE MORE APPROPRIATE TO SELECT A DIFFERENT AGENCY IN ORDER TO GAIN THE ADVANTAGES OF A DIFFERENT EXPERIENCE WITH THE PILOT CONCEPT. AFTER CONSIDERABLE DISCUSSION AND INTERNAL WEIGHING OF THE ADVANTAGES AND DISADVANTAGES, THE RECOMMENDATION TO DESIGNATE THE DEPARTMENT OF TRANSPORTATION HAS BEEN FORWARDED TO THE PRESIDENT AND WE EXPECT THE DESIGNATION WILL BE ANNOUNCED IN A MATTER OF DAYS.

IMPLEMENTATION OF 8(A) PRICE COMPETITION PILOT

DURING FY 1986, THE SMALL BUSINESS ADMINISTRATION SIGNED A MEMORANDUM OF UNDERSTANDING (MOU) WITH THE DEPARTMENT OF NAVY TO IMPLEMENT THE PRICE COMPETITION PILOT. THE MOU ALLOWS THE SBA AND NAVY TO JOINTLY SELECT, USING EXISTING 8(A) PROCEDURES, POTENTIAL PROCUREMENTS WHICH APPEAR TO BE WITHIN THE CAPABILITY OF TWO OR MORE 8(A) FIRMS. (APPENDIX IX) THE DEPARTMENT OF NAVY HAS AGREED TO ISSUE SOLICITATIONS TO SBA-CERTIFIED 8(A) FIRMS AND TO BE RESPONSIBLE FOR ALL PROCUREMENT ACTIONS UP TO THE POINT OF CONTRACT EXECUTION. WE ARE DEDICATED TO SUCCESSFUL IMPLEMENTATION OF THIS PROGRAM.

REPORT ON USER FEES

OUR SEPTEMBER 30, 1986 USER FEE REPORT WAS TRANSMITTED TO THE CONGRESS IN RESPONSE TO THE REQUIREMENTS OF SECTION 10011 OF PUBLIC LAW 99-272--THE RECONCILIATION BILL. (APPENDIX V) THE REPORT WAS PREPARED BY AN SBA TASK FORCE COMPRISED OF SENIOR SBA STAFF OFFICIALS AND PROGRAM MANAGERS.

THE REPORT, WHICH ADDRESSES A TOTAL OF 107 AGENCY SERVICES, IS DIVIDED INTO THREE SECTIONS:

THE FIRST SECTION DISCUSSES THE METHODOLOGY USED TO DEVELOP THE STUDY, LISTS USER FEE TASK FORCE MEMBERS, AND DISCUSSES SOME OF THE LIMITATIONS ON THE USE OF DATA.

THE SECOND SECTION LISTS ALL 29 AGENCY SERVICES FOR WHICH A FEE IS CURRENTLY IMPOSED, SPECIFIES THE AMOUNT OF THAT FEE, AND DISCUSSES HOW THAT FEE WAS DETERMINED.

THE THIRD SECTION LISTS THOSE AGENCY SERVICES FOR WHICH NO USER FEE IS CURRENTLY IMPOSED, PRESENTING THEM IN THE FOLLOWING TWO SUBSECTIONS:

-- SERVICES PROVIDED FOR WHICH NO FEE IS CURRENTLY IMPOSED, BUT SHOULD BE. THIS SECTION IDENTIFIES 33 SBA SERVICES WHICH ARE SUGGESTED FEE CANDIDATES.

-- SERVICES PROVIDED FOR WHICH NO FEE IS CURRENTLY IMPOSED AND SHOULD NOT BE. THIS SECTION IDENTIFIES 45 SBA SERVICES WHICH WERE DETERMINED NOT TO BE VIABLE FEE CANDIDATES.

SINCE THE COMPLETION OF THE SEPTEMBER 30, 1986 TASK FORCE REPORT, THE AGENCY HAS CONTINUED TO WORK ON THE USER FEE ISSUE THROUGH:

I) AN IN-HOUSE USER FEE POLICY GROUP

2) A National Advisory Council User Fee Task Force

Both of these groups have made recommendations on SBA user fees.

In addition, at the request of the Administrative Conference of the United States, we have provided comments on a draft report on Federal user fees that was recently submitted to the conference by two professors.

REVITALIZATION OF THE NATIONAL ADVISORY COUNCIL

The SBA National Advisory Council is a valuable asset to the Administrator, and its revitalization has always been one of my top priorities.

The NAC should not be used as a vehicle for encouraging grass-roots lobbying for or against agency legislative proposals, as has been done in the recent past. Pages II2-I46 of the meeting transcript for March 20, I986 illustrate the ways in which the NAC has occasionally wandered from its appropriate function. (APPENDIX VI)

Under the leadership of a new chair, the NAC has become an active partner in the development of new program initiatives and a valuable resource for agency program managers.

In early September, I had the distinct pleasure of addressing the members of the National Advisory Council at its semi-annual meeting in Scottsdale, Arizona.

I emphasized that it was my desire to strengthen the relationship between SBA and the NAC. Specifically, I expressed my earnest desire to cultivate a strong liaison between key SBA program staff and the NAC Committee chairs. I also called for members of the council to be kept informed of all council decisions and major agency initiatives and to have an opportunity to comment on new regulations and SOPs prior to final action.

Also, in order to ensure that this revitalization expanded to the regional (district-level) advisory councils, last November I directed each of the agency's ten regional administrators to update, improve, and promote to every extent possible, the membership of each advisory council in their regions.

At the September NAC meeting I created three task forces to focus on three high-priority topics. The first was a task force to examine the agency's User Fee Task Force Report to Congress and make recommendations to the Administrator.

THE FINDINGS OF THAT TASK FORCE, AS I HAD ADVISED ITS MEMBERS WHEN IT WAS ESTABLISHED, WILL BE PASSED ON TO THE NEW ADMINISTRATOR.

ADDITIONALLY, I APPOINTED TWO OTHER TASK FORCES COMPRISED OF NAC MEMBERS TO REVIEW THE 8(A) PROGRAM AND OUR SIZE STANDARDS POLICY. THESE RESPECTIVE GROUPS HAVE ALSO ISSUED REPORTS THAT WILL BE SHARED WITH THE NEW ADMINISTRATOR.

FINALLY, I HAVE ASKED OUR NAC INTERNATIONAL TRADE COMMITTEE, HEADED BY JOHN SHEPHERD, TO HOLD A JOINT MEETING WITH OUR AGENCY INTERNATIONAL TRADE STAFF AND BUSINESS DEVELOPMENT EXPERTS TO REASSESS OUR ENTIRE INTERNATIONAL TRADE EFFORT AND RECOMMEND NEW APPROACHES THAT CAN GUARANTEE A MORE SUCCESSFUL DELIVERY OF INFORMATION AND ASSISTANCE TO THE WIDEST POSSIBLE AUDIENCE OF POTENTIAL SMALL BUSINESS EXPORTERS.

SOP FOR BUSINESS DEVELOPMENT PROGRAM

IN 1985, THE OFFICE OF BUSINESS DEVELOPMENT WAS AUTHORIZED AND WITH THAT CHANGE CAME A NEW FOCUS.

THE PREDECESSOR ORGANIZATION, THE OFFICE OF MANAGEMENT ASSISTANCE FOCUSED ON COUNSELING, TRAINING, AND INFORMATION DISSEMINATION PERFORMED IN LARGE PART THROUGH DIRECT INTERVENTION BY AGENCY PERSONNEL USING AGENCY FINANCIAL RESOURCES.

THE NEW ROLE OF THE OFFICE OF BUSINESS DEVELOPMENT EMPHASIZES THE LEVERAGING OF RESOURCES AND THE NEED TO MANAGE THOSE RESOURCES IN ORDER TO ACHIEVE SPECIFIC AGENCY OBJECTIVES.

TO ENSURE THE FULL IMPLEMENTATION OF THE BUSINESS DEVELOPMENT CONCEPT, NEW STANDARD OPERATING PROCEDURES (SOP) WERE WRITTEN AND ARE NOW BEING IMPLEMENTED. A MANAGEMENT MONITORING SYSTEM HAS BEEN DEVELOPED THAT WILL TRACK THE PROGRESS MADE IN IMPLEMENTING THE PROGRAM IN EACH FIELD OFFICE AND EMPLOYEE EVALUATIONS WILL BE TIED TO THE RESULTS ATTAINED.

THE NEW SOP EMPHASIZES STRATEGIC PLANNING. IT IS THE AIM OF BUSINESS DEVELOPMENT TO ASSIST OUR RESOURCES TO SET GOALS, INSTITUTE A PLANNING PROCESS, AND ENSURE A COOPERATIVE SPIRIT THAT WILL DOVETAIL WITH THE GOALS AND INITIATIVES OF THE AGENCY.

ANOTHER AREA OF IMPORTANCE WITHIN THE BUSINESS DEVELOPMENT SOP IS MARKETING AND OUTREACH. PRIOR TO THE FORMATION OF BUSINESS DEVELOPMENT, THE AGENCY LACKED A CENTRAL POINT WITHIN THE ORGANIZATION TO COORDINATE MARKETING AND OUTREACH ACTIVITIES OF THE AGENCY. THE PLACING OF THIS RESPONSIBILITY WITHIN BUSINESS DEVELOPMENT WILL ASSURE A MINIMUM OF DUPLICATION OF EFFORT AMONG OUR RESOURCES. SPECIFIC DUTIES ARE DEFINED FOR EACH LEVEL OF THE AGENCY'S ORGANIZATION SO THAT AUTHORITIES AND RESPONSIBILITIES DO NOT OVERLAP.

ANOTHER AREA THAT IS BEING EMPHASIZED WITHIN BUSINESS DEVELOPMENT IS RESOURCE MANAGEMENT. IF SBA IS GOING TO FULFILL ITS MANDATE TO SUPPORT SMALL BUSINESS, WE MUST IMPROVE THE MANAGEMENT OF OUR RESOURCES. BUSINESS DEVELOPMENT PERSONNEL WILL BE RECEIVING TRAINING SUPPORT IN THIS AREA. WE MUST BE GOOD SALESPEOPLE, GOOD NEGOTIATORS, AND GOOD LISTENERS. BY IMPROVING OUR RESOURCE MANAGEMENT SKILLS, WE CAN OBTAIN GREATER SUPPORT FOR SMALL BUSINESS FROM THE PRIVATE SECTOR AS WELL AS OUR SUPPORT ORGANIZATIONS SUCH AS SBDC, SCORE/ACE, AND SBI.

WE HAVE SPECIAL PROGRAMS THAT NEED SPECIAL UNDERSTANDING. OUTREACH EFFORTS WILL BE INCREASED TO OUR VETERAN POPULATION AND OUR WOMEN BUSINESS OWNERS. GREAT CARE HAS BEEN TAKEN TO ASSURE THAT THESE PROGRAMS ARE HIGHLIGHTED WITHIN OUR OPERATING PROCEDURES.

WE BELIEVE THAT THE NEW GUIDANCE BEING GIVEN TO OUR FIELD OFFICES AND TO OUR RESOURCES WILL PUT IN PERSPECTIVE, FOR THE FIRST TIME, THE ACTIVITIES THAT THE AGENCY WANTS TO ACCOMPLISH. IT WILL INSTITUTE A PROCESS THAT ANY SUCCESSFUL BUSINESS MUST HAVE TO SUCCEED: GOOD PLANNING, AN EFFECTIVE OUTREACH PROGRAM, PROPER GUIDANCE TO OUR SUPPORT ORGANIZATIONS, AND SPECIAL INSTRUCTIONS FOR THOSE AREAS WHERE WE NEED TO MAKE EXCEPTIONAL PROGRESS.

REASSESSMENT OF AGENCY'S INTERNATIONAL TRADE PROGRAM

In recent years the Office of International Trade has focused on trade mission activity. This type of activity has had minimal impact when considering the scope of assistance that is needed by small business in the international trade area. The trade mission support is being provided by private sector entities and other organizations.

At the present time, the agency's International Trade effort is undergoing a reassessment.

It is clear that if SBA is going to have meaningful impact in the international trade area, it will be in the area of information dissemination and education support through outreach programs such as conferences, seminars, and workshops which identify potential small business exporters and link them with needed information and assistance.

We will be meeting with small business groups, and State and local governments to determine the type of information that does not currently reach the small business community and what educational support is needed. We are soliciting assistance from the private sector to develop and implement these outreach efforts. We will also work with other Federal programs, such as the International Trade Administration (ITA) to make sure that our activities complement theirs.

A CLOSER WORKING RELATIONSHIP WITH SMALL BUSINESS ORGANIZATIONS, STATE AND LOCAL GOVERNMENTS, AND THE PRIVATE SECTOR WILL ASSURE THAT THE PROGRAMS BEING DEVELOPED AND IMPLEMENTED WILL HAVE A GREATER IMPACT ON SMALL BUSINESS.

AND NOW, I'D LIKE TO GIVE A SHORT OVERVIEW OF THE PRESIDENT'S FY '87 BUDGET PROPOSALS FOR THE SMALL BUSINESS ADMINISTRATION AND ANSWER THE SPECIFIC QUESTIONS ASKED IN YOUR FEBRUARY 9 LETTER OF INVITATION.

THE BUDGET PROPOSALS, WE BELIEVE, ARE REASONABLE AND PRAGMATIC APPROACHES IN LIGHT OF THE GOVERNMENT'S OVERALL BUDGET DEFICIT OF MORE THAN $170 BILLION IN THE CURRENT FISCAL YEAR.

PROPOSED FY 1988 BUDGET -- GENERAL COMMENTS

THE ADMINISTRATION'S FY 1988 BUDGET REQUEST FOR THE SMALL BUSINESS ADMINISTRATION CAREFULLY BALANCES THE REQUIREMENT TO REDUCE THE SIZE OF THE FEDERAL BUDGET DEFICIT WITH THE CONGRESSIONAL INTENTIONS INHERENT IN THE FEDERAL PROGRAMS OF THE SBA THAT ARE ESSENTIAL FOR CONTINUED VITALITY OF OUR SMALL BUSINESS SECTOR. THIS BUDGET LOOKS FORWARD RATHER THAN BACKWARD. IT PROPOSES TO CONCENTRATE THE AVAILABLE RESOURCES TO MEET AND ADDRESS THE PROBLEMS OF THE FUTURE, RATHER THAN THOSE OF YESTERDAY. THE PROPOSED SBA BUDGET REQUESTS $379.3 MILLION IN NEW BUDGET AUTHORITY AND A STAFFING LEVEL OF 4,227 FTE POSITIONS.

THIS BUDGET SUBMISSION REPRESENTS THE ADMINISTRATION'S RECOGNITION OF THE IMPORTANT POSITION THAT THE SMALL BUSINESS SECTOR OCCUPIES WITHIN OUR ECONOMY. THUS THE PROPOSED BUDGET TAKES INTO CONSIDERATION TWO CRITICAL REQUIREMENTS FOR THE CONTINUED VITALITY OF THE SMALL BUSINESS COMMUNITY:

I. HEALTHY AND STEADY GROWTH OF OUR ECONOMY TO ENCOURAGE ENTREPRENEURSHIP; AND

2. EXISTENCE OF FREE AND COMPETITIVE MARKETS TO ALLOW THE COMPETITIVE SPIRIT OF THE SMALL BUSINESS ENTREPRENEUR TO DEVELOP TO ITS FULL POTENTIAL.

TO ACHIEVE THIS, THE FEDERAL BUDGET DEFICIT MUST BE BROUGHT UNDER CONTROL AND EVENTUALLY ELIMINATED.

BECAUSE THE SMALL BUSINESS SECTOR IS AFFECTED MORE THAN ANY OTHER SECTOR OF OUR ECONOMY BY THE HARMFUL EFFECTS OF UNCONTROLLED DEFICITS, THE SBA BUDGET PROPOSAL MAKES SIGNIFICANT CONTRIBUTIONS TOWARD DEFICIT CONTROL. THIS IS ACHIEVED NOT BY ANY MAJOR CUTBACKS OR ELIMINATION OF ANY ESSENTIAL PROGRAMS, BUT THROUGH CONTINUED IMPROVEMENTS IN MANAGEMENT AND PRODUCTIVITY, REDUCTION OR ELIMINATION OF NO LONGER JUSTIFIABLE SUBSIDIES THROUGH APPROPRIATE USER FEES, AND THE SALE OF LOAN ASSETS. NOW LET ME ADDRESS THE SPECIAL PROPOSALS CONTAINED IN OUR FY '88 BUDGET REQUEST.

I. Loan Asset Sales

The overall Federal budget for FY 1988, submitted by the President, proposes the sale of existing loan assets. The sale of assets is expected to generate $643 million in receipts in FY 1988; $254 million from the sale of Disaster loans; $140 million from Business loans; and $249 million from FFB 503 loans. Additionally, the budget proposal reflects receipts of $277 million from the sale of disaster loans in FY 1987. These sales, while making a substantial contribution to the reduction of the overall Federal deficit, will also produce:

1. Substantial reductions in our future loan servicing costs and, in turn, resource requirements; and

2. Factual data for use in estimating the true subsidy levels for the various SBA credit programs.

In preparation for these proposed sales we have issued a Request for Proposal (RFP) to secure a financial consultant to advise us on these matters. (APPENDIX VII) The consultant will be required to analyze the portfolio in order to recommend which loans should be sold and at what price.

As a result of this initiative we have received an unsolicited proposal. We notified the parties involved to tell them of the impending RFP and thank them for their interest.

Finally, I would like to inform you of the Administration's plan to issue its FY 1988 proposal on Federal Credit in March, with amendments to the FY 1988 budget request. At that time we will be happy to discuss with you how this proposal will affect SBA's credit program.

II. Reduction in Guaranty Percentage

Under existing law the guaranty percentages on 7(a) loans are these:

1. Not less than 90% on loans of $155,000 and under;

2. Between 70% and 85% on loans in the range between $155,000 and $714,285; and

3. Less than 70% on loans exceeding $714,285.

The proposed legislation would amend the Small Business Act to gradually reduce the existing participation percentage on loans

GUARANTEED BY THIS AGENCY IN THE FOLLOWING MANNER:

1988: REDUCE FROM 85% TO 80% THE PARTICIPATION RATE ON LOANS IN THE RANGE BETWEEN $155,000 AND $714,285

1990: REDUCE FROM $155,000 TO $100,000 THE VALUE ON LOANS GUARANTEED AT 90%

1992: ALL LOANS UP TO $714,285 WOULD BE APPROVED AT A PARTICIPATION RATE OF 75% OR LESS.

LOWERING THE GUARANTY PERCENTAGE WILL HAVE TWO BENEFICIAL BUDGETARY EFFECTS. FIRST, IT WOULD LOWER PROGRAM COST PER DOLLAR OF LOAN, SINCE SBA WOULD BE GUARANTEEING A SMALLER PERCENTAGE AGAINST LOSS ON EACH LOAN DOLLAR. SECOND, A LOWER GUARANTY PERCENTAGE SHOULD ENCOURAGE MORE QUALITY LENDING AND LOWER LOSS RATES. AT THE SAME TIME THE LEVEL OF FEDERAL PARTICIPATION IS SIGNIFICANT ENOUGH TO ASSURE CONTINUED LENDING BY PRIVATE FINANCIAL INSTITUTIONS TO SMALL BUSINESSES.

SBA HAS COMPARED CHARGE-OFF RATES (CHARGED OFF SBA AMOUNT DIVIDED BY DISBURSED SBA AMOUNT) BETWEEN LOANS WITH A 90% GUARANTY AND THOSE WITH A 70 - 80% GUARANTY. LOANS IN THE LATTER CATEGORY HAVE CHARGE OFF RATES 16.3% LOWER THAN THE 90% LOANS. THIS IS CONSISTENT WITH THE EXPECTATION THAT THE LOWER

THE GUARANTY PERCENTAGE THE HIGHER THE LOAN QUALITY, SINCE THE PRIVATE SECTOR LENDER IS ASSUMING MORE OF THE RISK AND WILL THEREFORE MAKE MORE CAREFUL LOAN APPROVAL DECISIONS.

IF WE APPLY THIS PERCENTAGE TO THE FY 1986 ACTUAL GUARANTEE CHARGE-OFFS OF $308 MILLION, THIS WILL TRANSLATE TO AN ANNUAL SAVINGS TO THE FEDERAL GOVERNMENT OF APPROXIMATELY $50 MILLION IN CHARGED-OFF LOANS.

III. ELIMINATION OF DIRECT LOANS

UNDER THE PROPOSED LEGISLATION ALL DIRECT LOANS EXCEPT FOR MESBICS WOULD BE ELIMINATED. OF THE $2.7 BILLION IN LOANS TO SMALL BUSINESSES BY SBA IN FY 1986 LESS THAN $50 MILLION OR UNDER 2% OF ALL LOANS MADE WERE DIRECT LOANS.

THIS PROPOSAL WOULD BENEFIT BOTH THE SMALL BUSINESS PERSON AND THE TAXPAYER CONSIDERING THE SIGNIFICANT COST OF DIRECT LENDING AND THE RELATIVE MINIMAL IMPACT DIRECT LENDING HAS HAD COMPARED TO OUR GUARANTEE LENDING.

FOR THE BORROWER IT WOULD MEAN THAT ALL SBA GENERAL BUSINESS LOANS WOULD BE MADE THROUGH BANKS. FOR SMALL BUSINESSES, BORROWING FROM A BANK INSTEAD OF FROM THE SBA WOULD MEAN THAT THEY COULD DEVELOP A RELATIONSHIP AND A TRACK RECORD WITH A PRIVATE SECTOR LENDER RATHER THAN WITH A GOVERNMENT AGENCY.

ONE OF THE PURPOSES OF THE SBA PROGRAM IS TO FOSTER LONG TERM GROWTH OF INDIVIDUAL SMALL BUSINESSES. THIS CAN BEST BE ACCOMPLISHED BY FOSTERING A RELATIONSHIP WITH THE MAJOR PRIVATE SECTOR INSTITUTIONAL PROVIDER OF CREDIT TO SMALL BUSINESS.

GUARANTEED LOANS ALSO PERMIT SMALL BUSINESSES TO BORROW GREATER AMOUNTS OF MONEY: IN EXCESS OF $500,000 MORE WITH A GUARANTEED LOAN VERSUS $I50,000 WITH A DIRECT.

INTEREST RATES ARE SIMILAR. IN MID-DECEMBER OF I986 THE DIRECT LOAN RATE WAS 8.25%. THE LEGAL MAXIMUM RATE ON GUARANTY LOANS IS 9.75% ON LOANS WITH A MATURITY OF OF SEVEN YEARS OR LESS AND I0.25% ON THOSE WITH GREATER MATURITY. MANY GUARANTY LOANS ARE MADE AT LESS THAN THE LEGAL MAXIMUM. RATES ON HANDICAPPED ASSISTANCE LOANS, CURRENTLY SET STATUTORILY AT 3%, WOULD RISE MORE SUBSTANTIALLY.

FOR THE TAXPAYER, GUARANTEED LOANS ARE PREFERABLE TO DIRECT BECAUSE THEY COST THE GOVERNMENT LESS. IN THE SHORT RUN THEY REQUIRE AN OUTLAY OF FEDERAL FUNDS ONLY WHEN AN UNCURED DEFAULT OCCURS AND SBA MUST PURCHASE THE LOAN FROM A BANK, WHEREAS A DIRECT LOAN REQUIRES AN OUTLAY OF GOVERNMENT FUNDS EACH TIME A LOAN IS MADE. IN THE LONG RUN, THE COST OF EACH PROGRAM IS BEST MEASURED BY THE LOSS RATE--NET CHARGE-OFFS DIVIDED BY TOTAL DISBURSEMENTS--AND THE LOSS RATE ON GUARANTEED LOANS IS LESS THAN IT IS ON DIRECT. AT SEPTEMBER 30, I986, THE ACTUAL

LOSS RATE ON DIRECT LOANS WAS 17.54% COMPARED TO A GUARANTEED LOAN LOSS RATE OF 6.99%.

IV. User Fees

The FY 1988 Budget Proposal provides for an $88 million increase in existing user fees. Of this amount $68 million is from the Business Loan program as a result of increases in various guarantee and transaction fees; $8 million from the Surety Bond program for increases in surety and contractor fees; $5 million from the disaster loan program for the increase of the existing interest rate to the Treasury cost of money and $7 million from programs financed from the Salaries and Expense Fund. (APPENDIX VIII) The proposed fee structure will:

1. Improve Agency programs through increased efforts by managers to make their programs more cost effective.

2. Induce future development of small business oriented services by State/local government, university and private industry owned and operated organizations (by eliminating the "free" alternate services supplied by the Federal Government).

V. Small Business Development Centers (SBDCs)

This budget request provides a total of $31.1 million in resources for support of the currently established and operating Small Business Development Centers (SBDCs). Such centers are now located in 42 States, the District of Columbia, Puerto Rico and the Virgin Islands.

The Administration also proposes to phase out Federal funding for "matured" SBDCs over a three year period. However, this should not be viewed as a major shift in program direction. We should remember that the original legislative intent was to stimulate creation of such Centers by Universities, by trade organizations and by other non-profit groups to meet the local small business training and business services needs.

The proposed five year phase-out formula allows the programs that are at the start-up phase to continue to receive Federal funding through 1991 while phasing out the more mature programs within three years.

VI. Consolidation of Minority Business Development Activities

The greatest beneficiary of the long overdue consolidation of Minority Business efforts, through transfer of Minority Business Development Agency (MBDA) functions and some of

THE PERSONNEL TO SBA, IS THE MINORITY BUSINESS SECTOR ITSELF. THE FY 1988 BUDGET PROPOSES TO TRANSFER 140 FULL-TIME EQUIVALENT POSITIONS AND $35.798 MILLION, INCLUDING $24 MILLION IN GRANT AUTHORITY, FROM THE DEPARTMENT OF COMMERCE.

THIS ACTION, IN ADDITION TO PRODUCING SAVINGS BY ELIMINATING DUPLICATION OF SERVICES AND UNPRODUCTIVE INTERAGENCY COMPETITION, WILL INCREASE THE EFFECTIVENESS OF GOVERNMENT ASSISTANCE TO THE MINORITY BUSINESS COMMUNITY THROUGH IMPROVED COORDINATION AND STREAMLINING OF PROGRAM DELIVERY SYSTEMS. THE EXTENSIVE NETWORK OF MINORITY BUSINESS DEVELOPMENT CENTERS (MBDCs) WILL PROVIDE SBA WITH A MORE INTIMATE PRESENCE IN MINORITY COMMUNITIES, WHERE 83% OF MINORITY BUSINESSES ARE LOCATED, ENABLING IT TO BE MORE RESPONSIVE TO THEIR REAL PROBLEMS AND NEEDS. IN TURN, THE MBDCs, BY BECOMING MORE SENSITIVE TO THE 8(A) AND OTHER SBA PROGRAM OBJECTIVES AND THE PROBLEMS FACED ~~BY THE PARTICIPANTS~~, WILL PROVIDE MORE EFFECTIVE ASSISTANCE TO THESE FIRMS AND IMPROVE THE RATE OF SUCCESSFUL EXPERIENCES WITH SBA PROGRAMS.

QUESTIONS REGARDING MBDA EMPLOYEES MUST AWAIT FURTHER DISCUSSION AND CLARIFICATION FROM THE DEPARTMENT OF COMMERCE.

THIS CONCLUDES THE FORMAL PORTION OF MY TESTIMONY. I WOULD BE PLEASED TO ANSWER YOUR QUESTIONS.

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF THE ADMINISTRATOR

FEB 19 1987

Honorable Joe Wright
Chairman
President's Council on
Integrity and Efficiency
OEOB Room 252
The White House
Washington, D.C. 20503

Dear Joe:

Please consider this a formal request that you convene a meeting of the PCIE's Investigations and Law Enforcement Committee so that I may present to the committee a matter of concern requiring, in my judgment, a statement of policy guidance from the PCIE.

I am referring to investigative activities carried out by Agency Office of Inspector General staff in response to allegations of violations of 18 U.S.C. Sec. 1913, popularly known as the anti-lobbying statute. Such an investigation was recently concluded by the SBA Inspector General, and an opinion rendered on February 10 by the U.S. Department of Justice (copy enclosed).

I believe that the PCIE should investigate this matter thoroughly. The SBA case can serve as an example from which the Committee can develop policy/legal guidelines that could protect Agency IG officials from having to expend resources in pursuit of dubious allegations that do not constitute violations of the law (under existing interpretations of 18 U.S.C. Sec. 1913).

There is unanimous opinion--from the GAO, the Department of Justice, and the Agency's General Counsel--that the law was intended to cover only "publicity and propaganda" intended to encourage "grassroots lobbying," not direct Congressional contacts by Agency legislative liaison staff. Yet, in the absence of clearer guidelines, Agency employees are vulnerable to politically-motivated investigations that serve no purpose other than political harassment.

I enclose pertinent GAO and DOJ information on the issue, and look forward to discussing it with you and the PCIE committee.

Sincerely,

Charles L. Heatherly
Deputy Administrator

Enclosures

cc: Senator Dale Bumpers
Senator Lowell Weicker
Representative John LaFalce
Representative Joe McDade
Raymond F. Randolph
Oliver B. Revell, PCIE, ILE Committee

(Enclosures retained in committee files.)

U.S. Department of Justice

United States Attorney

District of Columbia

Judiciary Center Operations
555 Fourth St. N.W.
Washington, D.C. 20001

February 10, 1987

Mr. Stephen N. Marica
Assistant Inspector General for Investigations
Office of the Inspector General
U. S. Small Business Administration
Washington, D.C. 20416

Re: Richard Nelson

Dear Mr. Marica:

We have carefully reviewed your prosecutive report concerning alleged criminal violations of anti-lobbying laws or obstruction of Congressional proceedings. In conjunction with your investigator Ron Freeman, we have taken several investigative steps and considered the facts and the laws applicable thereto.

We have concluded that there is no evidence of criminal conduct on the part of Mr. Nelson. As to the anti-lobbying laws, his activities are not prohibited by current interpretations of 18 U.S.C. § 1913. As to any illegality in the withholding of a document from Congress, we have concluded that there is no evidence of criminal intent on that matter.

Thank you for your referral of these matters.

Sincerely,

JOSEPH E. DIGENOVA
UNITED STATES ATTORNEY

By: William S. Block
William S. Block
Chief, Criminal Division

Senator LEVIN [presiding]. Senator Weicker.

Senator WEICKER. The Committee thoroughly examined the issue of increasing the fees during 1985. Later today we will receive testimony, as we did in 1985 from a representative of the Independent Bankers Association, that the increase of fees from 2 to 4 percent is likely to price borrowers out of the market. Mr. Wilkinson's written testimony states, this four point guarantee proposal works directly against the people in businesses that the SBA was specifically designed to assist. Do you believe this proposal will reduce demand for the program and did you consult with the bankers prior to deciding to recommend this increase?

Mr. HEATHERLY. Senator, we are aware of course, of the increase of a year ago from 1 to 2 percent. We have looked at this program very carefully to try to determine the impact of increases on demand. Based upon the historical record and based upon the economics of the interest rate picture, we believe that the borrower will be willing to pay the increased 3 percent fee considering the great decline in interest rates over the past 6 years under this Administration's leadership. The actual monthly increase in payments on a $150,000 loan, 10 year loan, would only be about $21. Under the double-digit interest rates of 1981, on that same loan, the payments would have been substantially higher. So, in the context of our economy and interest rate structure, and the fact that it is getting a reasonably good rate and a very favorable repayment schedule, we do not believe that the increase from 2 to 3 percent will have a significant effect on demand.

Senator WEICKER. Rather than get in a debate on that, you have stated your position, and we will wait to hear from Mr. Wilkinson.

The budget would eliminate all direct funding for the Handicapped Assistance Loan Program. One of the criteria for making direct handicapped loans is that the funds are not available otherwise from banks or a guaranteed loan, and so forth.

Now in your statement, on page 21, you say that one of the advantages of eliminating the program is that for small business, borrowing from a bank, instead of from the SBA would mean that they could develop a relationship and a track record with a private sector lender, rather than a Government agency.

That presumes they can get a bank loan in the first place. Do you really believe that the banks will make loans to the handicapped, and if that were true, do not SBA regulations as presently written, by requiring the loan not be made if funds are otherwise available, take care of the problem?

Mr. HEATHERLY. That statement is referring to the alternative, using our guarantee program, rather than Direct Loan Program, Senator. We feel that when a borrower, whether it be a handicapped person, a veteran, or anyone else goes to the bank, and the bank agrees to a loan with the SBA guarantee, we are standing behind them. And we are facilitating that loan. But at the same time, the borrower is developing a relationship and a track record with that bank. We think that is preferable to dealing directly with the SBA. In terms of the regulatory aspect of that question, I will refer to Mr. Holloway, because I am not certain of the answer.

Mr. HOLLOWAY. I believe Senator you were asking whether or not the funds had to be not otherwise available in order to qualify and be eligible for Handicapped Assistance Program.

Senator WEICKER. They have to do that anyway, in other words, I do not see that this adds to the existing law.

Mr. HEATHERLY. It is preferable to the long term interest of the borrower of that firm, of the small business. I think that we try to facilitate that, and the guaranty makes those funds available. And I think that we can do that.

Senator HARKIN. Would you yield on that?

Senator WEICKER. Certainly.

Senator HARKIN. If you are so interested in making these Guaranteed Loans and keeping the program going under the guarantee system, I would not for example, last year, fiscal year 1986 you made only seven guaranteed loans, and 128 direct. The first quarter of 1987 you made 16 direct and only one guaranteed loan. It does not seem like, I mean I would think that those numbers would be much higher in a guarantee if you were really interested in moving that direction, rather than just making one. For the quarter, you could keep up that record and you would have four for the whole year.

Mr. HEATHERLY. The record, for year to date, for 1987 year to date, on the Handicapped Loans is something that is surprising and disturbing to us. And we have sent out communications to our field in January, reminding all of our district offices that these funds are available in trying to spur interest and activity so that we can meet the targets and the funding levels. I am talking now about the direct loans that are available. I think that is a figure from where we are today, are somewhat unusual, and a quirk in terms of the calendar. I think we are going to meet those outlay levels, those approval levels during the rest of the year.

Senator WEICKER. I have other questions for submission for the record, but I would like to ask one last question. I would like to quote from your prepared statement. You said; "last August, I recognized the need to recover a sense of mission, and a commitment to renewal and revitalization, after two years of uncertainty and controversy." I mean if anybody created that controversy, Mr. Heatherly, I would suggest that you did. You took office as the acting Administrator and it was your intention to promote the President's proposal to transfer the SBA to the Department of Commerce, which Congress had already rejected. In April, the President signed the three year authorization for SBA. Between April and August, what did you do to revitalize SBA programs?

I think you know as well as I do, upon your arrival on the scene of the Small Business Administration, your activities undermined to an extent unparalleled, certainly in my career here, the morale of the entire agency. I would like to know what it is that you did, after the bill was signed, to revitalize the SBA's programs and revitalize the morale of that Agency, which you tore to shreds.

Mr. HEATHERLY. Well, Senator, though I may not agree with your terminology, your rhetoric, I think it is a fair question in its substance.

When I arrived at the SBA at the end of March, I had a charge, a mandate, a mission that I accepted as a condition for the appoint-

ment. I have always tried to give 100 percent to any job I undertake. And I tried to give 100 percent to that mission.

Senator WEICKER. And what was that mandate?

Mr. HEATHERLY. It was to try to sell and try to implement the President's proposals, as incorporated in his budget. Now you quite rightly point out the inconsistency between the budget proposals and the Reconciliation Act, which was signed on April 7. And that is something which I have wrestled with, and which I think will have to go down as a problem that the Administration did not think through at that time, and which I was not thoroughly apprised of at the time I took the position. I will be candid about that. But we did not see, at that time, that the signing of an Omnibus Reconciliation Act, of which the SBA bill was a small part, I think you will agree, of the total package, negated the President's budget proposals. And we were intent at that time on trying to persuade the Budget committees and the Appropriations committees of the desirability of some further improvements, some further reductions in line with the President's budget proposals.

Now with regard to what I did between April and August, you have to bear in mind that any Administration official that the Agency has, acting or otherwise, is under a mandate to represent official Administration policy. To articulate it, explain it, promote it, to the fullest extent possible. And until such time as the President made a change, or announced a change, decided to change in direction, I was obligated to carry that out. And I tried to do so.

Yet at the same time, I, in private discussions with the White House, beginning in May, when the Senate Budget Committee action was final, and the outcome of the budget battle was pretty much predictable, I did begin discussions with OMB and White House officials about the need to reevaluate and reassess our strategy.

The decision, however, on a new direction, a basic change in policy, did not come until August. When the President made that decision, I was on board immediately. One difference between me and some other people that may have sat in this chair over the years, is that I try very hard to stay in step with the President. Not a half step ahead, or a half step behind. And within those policy parameters, I did everything I could, administratively, within the Agency, by visiting district offices, by talking to staff, through interviews, to maintain morale. To make the point that these policy debates that are going on in the Congress and the Administration, that is policy, and that is politics, and the outcome will have to await the outcome of the policical process. But every professional in this Agency has a job to do. Everyone has a role to play. And we expect everyone to be professionals. You do your job, we are going to respect you, and we will get the job done.

Second, I made clear to everyone that we have a legislated, mandated mission, that programs will be administered according to the law and regulation. And I did my best to encourage people to carry out their responsibilities while the political process was working its way out. I participated in award programs, I participated in a lot of local meetings, district meetings. I participated with our Advisory Council staff, to try to keep them apprised and up to date, and the morale up. And I think on balance sir, and in terms of the Admin-

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istration's official policies, and the directions that I was under, that I did the best that I could under the circumstances.

Senator WEICKER. I find no fault certainly with serving your boss loyally. I have no problem with that. The problem is that the greater obligation is to see the law fulfilled.

Mr. HEATHERLY. I believe I did that, Senator.

Senator WEICKER. And very frankly, it was one thing to have a legislative proposal before the Congress to eliminate the Agency. The Administration has a right to do that. The fact is that nobody ever acted on it. And therefore, you were operating under our Constitutional process, under a law in being, in de facto, I mean to say you broke the law, that would be a very difficult case to prove. I am not in a position to prove it. In terms of de facto, demoralizing the effort, believe me, you did that, and did it very effectively.

Now point number two. You say this is a small part of the reconciliation package. Again, let me assure you, it was a very carefully crafted agreement between the Administration and the Congress. And as the principal negotiator for the Congress, there was not anything small about it. There was not anything indefinite about it. It was clearly an acceptance by the Administration that the Small Business Administration would continue to exist. As I said, I am not going to take the time in this Committee, because very frankly, I think there will be another in your place rather shortly. There is no point in covering this whole ground. But somehow, and I suppose this is what disturbs me as a Republican, I know a lot of you fellows over there do not think I am a Republican, but let me tell you.

Mr. HEATHERLY. We are counting on your vote, Senator.

Senator WEICKER. I will tell you, I believe in very strict construction of the law. And the cavalier way in which you take whatever your wish and sort of assume that that is the law, I find goes against every principle that I ever learned as a Republican. So I just want to tell you, I wish I could say to you Godspeed and whatever else. I just got to say, you brought this Agency to the brink of absolute disaster. You did so contrary to the law.

Mr. HEATHERLY. I disagree with that, Senator.

Senator WEICKER. Regardless of the statements you have made here about revitalizing and the rebuilding process, insofar as the executive branch is concerned, not so far as Congress is concerned, the rebuilding process has been sporadic, and that is what awaits your successor.

Mr. HEATHERLY. Senator, I appreciate the point you have made. I think it has some merit. But I do believe you exaggerate in the terminology you use regarding the violations, or not carrying out the law. That was a concern of the April 28 hearing, and there were a lot of allegations there about not carrying out the law, or Administrative dismantlement. But the fact is sir, not a single thing that came out of that hearing documented any impropriety on my part with regard to not carrying out the law. Nor has any such impropriety come to light in the last 10 months. I have studiously and conscientiously carried out the law. And I categorically reject and resent any imputation to the contrary.

Senator WEICKER. Thank you, Mr. Chairman.

Senator LEVIN. Thank you. Senator Harkin.

Senator HARKIN. Thank you. Senator Weicker covered the handicap issue I think quite well. I just wanted to point out that this Handicap Loan Program has provided about 200 loans a year in the past. I am just sort of averaging it out. I would just like to ask you, have you or your office analyzed the number of jobs created by the program, and how much it will cost the government, at all levels, not just the Federal, but at all levels, to provide assistance to those people if those jobs did not exist. I would like to see if you have anything like that, that you might submit to the Committee as we go into this process.

Mr. HEATHERLY. That is a fair question. I would like to get back to you on the record. I am not aware of the specific statistics.

Senator HARKIN. I would like to get them as we, obviously as we go into this budget and everything. I would like to get any figures you have on that.

Mr. HEATHERLY. All right.

Senator HARKIN. Others have talked about the loan portfolio sales, and I will not go into that. Mr. Chairman, thank you very much. I do not have any further questions.

[Material follows:]

3/13/87

HAL LOAN APPROVALS

FISCAL YEAR	LOAN TYPE	# EMPLOYEES	NO.LOANS	TOTAL AMOUNT	SBA AMOUNT
74	DIRECT/IP	2822	70	$9,626,300	$4,921,650
74	GUARANTEE	420	7	$911,000	$792,330
TOTAL	74	3242	77	$6,537,300	$5,714,000
75	DIRECT/IP	2624	69	$5,231,000	$5,009,422
75	GUARANTEE	628	10	$1,485,400	$1,207,360
TOTAL	75	3252	79	$6,716,400	$6,212,782
76	DIRECT/IP	5786	140	$10,645,200	$9,922,400
76	GUARANTEE	284	12	$730,250	$668,429
TOTAL	76	6070	152	$11,383,450	$10,588,829
76A	DIRECT/IP	411	36	$2,181,150	$2,132,400
TOTAL	76A	411	36	$2,181,150	$2,132,400
77	DIRECT/IP	4827	201	$13,989,189	$13,939,456
77	GUARANTEE	281	5	$988,000	$728,500
TOTAL	77	5108	206	$14,969,189	$14,267,956
78	DIRECT/IP	8235	309	$23,422,772	$23,080,222
78	GUARANTEE	708	10	$1,280,600	$1,122,540
TOTAL	78	8943	319	$24,703,372	$24,202,762
79	DIRECT/IP	5583	277	$20,626,443	$20,569,818
79	GUARANTEE	308	11	$1,316,200	$1,079,830
TOTAL	79	5891	288	$21,942,643	$21,641,648
80	DIRECT/IP	7310	252	$20,271,165	$19,927,782
80	GUARANTEE	49	8	$441,388	$397,170
TOTAL	80	7359	260	$20,712,465	$20,324,952
81	DIRECT/IP	6441	255	$25,434,667	$24,972,749
81	GUARANTEE	1086	20	$1,850,250	$1,449,225

HAL LOAN APPROVALS

3/13/87

FISCAL YEAR	LOAN TYPE	# EMPLOYEES	NO.LOANS	TOTAL AMOUNT	SBA AMOUNT
TOTAL	81	2729	279	$27,284,917	$26,621,974
82	DIRECT/IP	6149	169	$13,749,600	$13,591,350
82	GUARANTEE	226	4	$806,000	$725,400
TOTAL	82	6375	173	$14,551,600	$14,116,750
83	DIRECT/IP	5692	160	$15,397,930	$14,971,110
83	GUARANTEE	637	9	$2,081,000	$1,799,700
TOTAL	83	6329	169	$17,478,930	$16,770,810
84	DIRECT/IP	4869	180	$16,564,831	$16,298,301
84	GUARANTEE	129	5	$690,000	$538,825
TOTAL	84	4998	185	$17,254,831	$16,837,126
85	DIRECT/IP	9677	248	$24,451,625	$23,733,213
85	GUARANTEE	398	5	$1,063,000	$840,100
TOTAL	85	10075	253	$25,514,625	$24,573,313
86	DIRECT/IP	6337	127	$14,291,811	$14,219,136
86	GUARANTEE	156	7	$1,298,700	$1,038,244
TOTAL	86	6488	134	$15,590,511	$15,253,380
87	DIRECT/IP	994	29	$2,910,120	$2,910,120
87	GUARANTEE	141	3	$297,000	$200,700
TOTAL	87 (FEB)	737	32	$3,207,120	$3,110,820
TOTAL		83007	2638	$230,020,423	$222,361,490

Senator LEVIN. Senator Bond.

Senator BOND. Thank you, Mr. Chairman. Mr. Heatherly, how do you measure the effectiveness of the Small Business Development Centers? By what standards does your Agency determine whether they are accomplishing their mission or not?

Mr. HEATHERLY. That is a very good question to ask of any program, Senator. In this particular case, the indicators that we use are the number of people attending training sessions, counseling sessions, and basically those nose counts of various kinds. In other words, the penetration, the numbers of people exposed to the program, participating in the program. Some of the SBDCs, especially some of the more mature ones, such as in Georgia, Wisconsin, I believe make a more systematic effort to document their effect on the economy in terms of job impact, and so forth.

The efforts that the Agency has made for systematic evaluation have not been too successful. I do not believe the results have much credibility. And it is something that we are continuing to be concerned about. I think we need to do a lot better. We need more professional and more credible evaluation of this program as well as of the others.

Senator BOND. Would it not make more sense, rather than to make nose counts, to carry on with an economic analysis, to find out how many jobs are created, to what extent small business have utilized that knowledge?

Mr. HEATHERLY. We spent a lot of money, 3 or 4 years ago on such a study. A contracted study to a professional research firm, which looked at the impact over time of the program. I believe the period of study, correct me, was 1980 to 1981. And the results of the study, which was our most expensive one, the most thorough one that we had ever done at the SBDC program to date, the results were mixed and inconclusive. But certainly were not all that favorable or positive in terms of documenting the impact.

One of the rationalizations given at the time for basically dismissing this study, its findings, was that it had been conducted during a period of economic recession. Therefore the true impact of the program could not be documented. It sounded to me as a strange thing, since the program presumably does have some beneficial effects even during recession. Different effects, but certainly we should be able to document them, just as well as in a period of expansion.

But the bottom line, Senator, is I do not think that we have done a very good job of compiling those kinds of rigorous evaluations, credible evaluations, and it is something we need to devote more attention to.

Senator BOND. Would it not make sense to get that evaluation before you proposed phasing out the funding for them?

Mr. HEATHERLY. No, Senator, because, I am anxious to answer that, because I think it presumes an attitude on the part of the administration that the program is not worthwhile. Which we have not said. This is a matter of the Federal role, the appropriate Federal role, and whether there is or should be an indefinite commitment of the Federal Government to the support of the SBDC program.

We believe the program does accomplish many worthwhile things. There is demonstrable impact on the people counseled, the people trained. But it is a very expensive program. It is a very expensive program compared to our other counseling and training programs. We believe that it is too expensive for the Federal Government to maintain under the current budgetary climate, and that it is more appropriate for the State governments and the universities and educational systems to pick up this responsibility over a phased period of time. We are proposing a 5-year phase out. So it is not that we do not believe the program accomplished some good things. We think it is expensive, and we think it is not an appropriate Federal responsibility.

Senator BOND. Mr. Heatherly, we can certainly appreciate the fiscal constraints on the Federal Government. But I assure you, if you think it is too expensive for the Federal Government to pick up, there is a chance, somewhere between slim and none, that states and universities will be able to pick it up, given the difficulties in finding adequate financing they have for their activities.

I would feel much more comfortable if you were able to develop some kind of reliable standards and tests, which either show the program works, or it does not work, instead of trying to slip the responsibility to another level of Government. If it is too expensive per job created, then that is a judgement that we would like to hear.

Mr. HEATHERLY. Any test, or any evaluation of benefits in terms of the impact, must be weighed against cost. Cost benefit analysis. Our position is that there are benefits to the program, especially the individual clients that are served by it. But that it is an expensive program that the cost, per client, the cost per training hour, per counseling hour is very high compared to our other activities. And that in view of this, it would be best to phase this out over a period of time, 3 to 5 years, so that they could manage this transition to State and local funding.

Now it is quite true that we do not see that most of the States are going to jump at this prospect; they are not going to stand up and applaud at this prospect. At the same time, the Congress did reduce, in its wisdom last session, in general Federal revenue sharing, to the tune of several billion dollars, and the States had no choice but to acquiesce in this. When this SBDC program was created, back in the late 1970s, we had Federal revenue sharing. Today we have no revenues to share, we only have deficits to share.

Senator BOND. Would you not expect that, given the assessment by your Agency that it was too expensive, that States would by and large not be interested in picking up this activity? Are you saying in effect that it is not a phase-out or transition to state and university funding, but it is essentially an end to the program?

Mr. HEATHERLY. No, Senator, I honestly do not believe that. I have talked with the many SBDC staff during the course of my speeches around the country. In Denver and elsewhere, people come up to me who work in the SBDC community, and several of them have admitted to me privately, I am not sure they would come before this Committee and state so publically, but they admit privately that they are ready for a phase out of Federal funding.

That they can in fact make it on their own. They have solid support in the States, and given a reasonable timeframe, not cold turkey over night, but given a reasonable schedule, they could and should move to independence. Independent of the Federal oversights, Federal regulation, Federal redtape, and the Federal funding.

Senator BOND. Thank you Mr. Chairman.

Senator LEVIN. Mr. Heatherly, prior to your recommendations in the budget that the loan guarantee portion be reduced, did you do a study on what the impact of that would be?

Mr. HEATHERLY. We knew one of the impacts would be higher quality loans and lower losses paid for by the tax payer.

Senator LEVIN. Did you do a study, I am not asking you now to.

Mr. HEATHERLY. We did a study in——

Senator LEVIN. Would you share that study with the Committee?

Mr. HEATHERLY. We will share all the data we have with you, Senator. The loans made with higher bank participation are higher quality loans than 90 percent loans, and have a lower default rate.

Senator LEVIN. Without getting into details, I just want to know if you did a study, and if so would you share that with the Committee.

Mr. HEATHERLY. We will share all the data we have with you, Senator.

Senator LEVIN. Your recommending of the budget, that the fee go up from 1 percent to 2 percent, did you do a study on the impact of that?

Mr. HEATHERLY. On the Guarantee Loan Program? We are recommending that the fee go from 2 to 4 percent. To 3 percent for the borrower, and a 1 percent fee to the banks or lending institution would have to absorb.

Senator LEVIN. Without getting into the details of the specific increases, all I want to know is did you do a study of that?

Mr. HEATHERLY. We did not do a separate study of that impact. We analyzed our historical experience with the program, our recent experience with the increase to 2 percent. And our understanding, it is a supply demand situation on those loans. The kind of clients we are serving, the economics of it, and we are convinced that it would not undermine the program.

Senator LEVIN. Did you do a study or an analysis?

Mr. HEATHERLY. We did an analysis.

Senator LEVIN. Would you share that analysis with the committee?

Mr. HEATHERLY. Yes, Senator.

[Material follows:]

COST REDUCTION IN THE 7(a) GUARANTEED LOAN PROGRAM: AN ANALYSIS OF OPTIONS

(Note: This analysis was conducted by the Office of Finance and Investment, with the assistance of the Office of the Comptroller.)

I. METHODOLOGY

This paper will examine two options for reducing governmental costs in the SBA 7(a) loan guarantee program: increasing the fee paid as a percentage of the amount guaranteed (currently 1%) and lowering the guaranty percentage. The exercise of such options, by increasing the price of the guaranty, would probably tend to dampen demand. However, the measurement of such effects is beyond the scope of this paper.

Income and costs in the program can be grouped into the categories shown in Table 1.

In order to most clearly show the effects of varying the guarantee fee and the guaranty percentage, figures in the income and expense categories in Table 1 were calculated on the basis of cents per dollar of guaranteed amount or cents per dollar of loan amount. For example, the guarantee fee currently is 1¢ per dollar of guaranteed amount.

With reference to Table 1, the rationale for the assumptions regarding the time periods during the life cycle of a loan in which each of the cost and income categories occurs (e.g., during the first year, during all 9 years, etc.) is as follows:

- Guarantee fee is a one time fee paid at time of settlement, and therefore occurs in year 1 only.

- Interest income is income from purchased loans and would be a recurring event. Normally, this income would be offset against the interest expense on borrowings from Treasury. However, since data for the latter were not available as a unique allocation to the 7(a) program at the time this analysis was conducted, the assumption was made for the purpose of this analysis that the two are offsetting. The analysis will be recomputed at an early date to explicitly include interest income and expense as soon as the necessary data are available.

- Salaries and Administrative expenses are one-time costs associated with loan making and occur during the first year only.

- Portfolio management is a recurring cost through the life of the loan.

- Losses: The Office of the Comptroller has compiled data indicating that purchases of loans occur during the first 7 years of the typical loan cohort's life as shown in Table 2.

TABLE 1

INCOME AND EXPENSE CATEGORIES IN THE 7(a) LOAN GUARANTY PROGRAM

INCOME	YEAR(S) OF OCCURRENCE[3]
Guarantee fees	1
Interest income[1]	1-9
DIRECT EXPENSES	
Salaries and administrative[1]	1
Portfolio management[1]	1-9
INDIRECT EXPENSES	
Personnel, financial management legislative, executive, auditing, investigative, computer, legal and miscellaneous services.[1]	Half=1 Half=1-9
INTEREST EXPENSE TO TREASURY	1-9
ULTIMATE LOSSES ON LOANS[2]	1-7

[1]Data for these items is from Office of the Comptroller, "Program Costs, Fiscal Year 1981."
[2] Data is from Office of Accounting Operations, "FY 1984 Loss Rates." Ultimate losses at any point in time are defined as total actual and estimated future losses divided by total disbursements.
[3]Year 1 is the year in which the loan is made. Year 2 is the year after the loan is made, etc.

NOTE: The cost of the direct and indirect expense items is calculated as follows: The Office of the Comptroller has estimated the total dollar cost of these items in fiscal year 1981 for each of SBA's major programs (see footnote 1). For the costs that occur only in year 1, cost per dollar of guaranteed loan amount is derived by dividing total program cost by the program level for guaranteed loans in FY 1981. The SBA share of $2.8 billion is used in Tables 3 and 5. The total loan amount of $3.2 billion is used in Tables 6 and 7. The recurring costs arise to service the entire 7(a) guaranteed loan portfolio, rather than the loans made in any one year. Therefore, the recurring costs per dollar of guaranteed loan are derived by dividing by the figure for the total 7(a) portfolio in FY 1981. The figure for SBA share ($8.78 billion) is used in Tables 3 and 5. The figure for total loan amount ($9.98 billion) is used in Tables 6 and 7. This figure was relatively constant over this period: $9.0 billion in 1982, $8.8 billion in 1983, and $8.9 billion in 1984. The average life of an SBA loan is 9 years.

TABLE 2

YEAR	Of loans that are purchased % that are purchased in each year
1(year loan is made)	1.43
2	13.36
3	19.95
4	31.18
5	18.23
6	9.96
7	5.89
	100.00

Liquidation generally is completed in the year following purchase; therefore, the occurrence of losses was lagged one year behind the year of purchase. For example, 1.43% of the losses are assumed to occur in year 2 of our typical loan cohort's life (one year after the loans in the cohort are made).

- o Interest Expense to Treasury: See discussion under interest income.

- o Indirect Expenses are allocated half during the first year and half as recurring expenses over the life of the loan, as these support both the first year loan making activity and the ongoing portfolio management activity.

Since this is a multi-year analysis, all income and expense figures used below are present value, using an 11.78% discount rate (the 5 year average yield on 10 year Treasury securities, 1979-1983).

II. INCOME AND EXPENSES IN THE 7(a) LOAN GUARANTEE PROGRAM PER DOLLAR OF GUARANTEED AMOUNT

With the preceding data sources and methodology, the basic income and expense figures of the 7(a) loan guarantee program are as shown in Table 3.

The present value of the program's net cost per dollar of guaranteed amount, counting direct expenses, indirect expenses, ultimate losses on loans and a 1% guaranty fee is 9.44¢. With a 3% fee the cost would decline to 7.44¢, and would decline further to 5.44¢ with a 5% fee.

III. IMPACT UPON SMALL BUSINESS BORROWER

The impact upon the small business borrower is most graphically measured by assuming that the increase in fees is financed by increasing the size of the loan by an amount equal to the fee, and then noting the resulting percentage increase in monthly payments. It is a common practice in many financial sectors to finance up-front fees or "points" in this way. For a typical SBA loan the percentage increase in monthly payments for a 3% fee would be 1.73% (Table 4). The increase would be 3.42% for a 5% fee. While such increases are by no means insignificant, they should not be prohibitive.

TABLE 3

Income and Expenses Compared to Guaranty Amounts

Income and Expenses	Present Value per dollar of Guaranteed Amount
	¢
Income	
Guaranty Fee	1.00
Direct Expenses	
Salaries and Administrative	.42
Portfolio Management	1.77
Indirect Expenses	.45
Ultimate Loss	7.80[1]
Net Income or (Program Cost)	(9.44)
With 3% fee	(7.44)
With 5% fee	(5.44)

[1]This is the present value of an estimated ultimate loss figure of 12.1¢, as calculated by the Office of Accounting Operations as of Sept. 30, 1984. The estimate is based upon historical experience, which may or may not be an accurate forecast of future losses.

TABLE 4

Impact Upon Borrower of Increasing Fees

Fee	Loan Size ($)	Monthly Payment ($)	% increase in Monthly Payment compared to 1% Fee (%)
Current 1% fee	171,063	2,719	
3% fee	173,971	2,766	+1.73
5% fee	176,879	2,812	+3.42

NOTE: Calculations assume:

1. Fee increase financed by increasing loan size by amount equal to fee increase.

2. Loan size = average guaranteed loan size in FY 1984.

3. Term = 9 years, average term for 7(a) guaranteed loans

4. Interest rate = 13.25%, composed of 10.5% (New York prime on February 6, 1985)+ 2.75% maximum allowable add on.

IV. EFFECT OF DECREASING THE GUARANTY PERCENTAGE

Currently the average guaranty percentage for guaranteed loans is 88%. (Office of the Comptroller) Lowering the guaranty percentage to 70 percent would, by itself, have no affect upon ultimate losses per dollar of guaranteed amount, although it would, as we see below, have a significant effect upon losses per dollar of loan. However, a comparison of charge off rates (charged off SBA amount divided by disbursed SBA amount) between loans with a 90% guaranty and loans with a 70 - 80% guaranty reveals that loans in the latter category have chargeoff rates 16.3% lower than the 90% loans. This is consistent with the expectation that the lower the guaranty percentage the higher will be the loan quality, since the private sector lender is assuming more of the risk. (The analysis was performed on loans made from Fiscal Year 1974 through the first quarter of FY 1985.) Data were not available to calculate the difference in the ultimate loss rate (chargeoffs minus recoveries divided by disbursements) between the 90% and the 70 - 80% loans. However, there is no reason to believe recoveries would be greater on 90% loans than on 70 - 80% loans; if anything, recoveries might be greater on the latter because of increased loan quality. In the current analysis, therefore, a 16.3% reduction in the ultimate loss rate is assumed as a result of a decrease to a 70% guaranty.

The effect of this reduction is to lower the net cost to 8.17¢ per dollar if the current 1% fee structure is retained. If fees are increased to 3%, the cost would fall further to 6.17¢ and at 5% the cost would be 4.17¢. (Table 5)

V. INCOME AND EXPENSES PER DOLLAR OF LOAN AMOUNT

Another way to analyze the income and expenses in the 7(a) guarantee program is to look at these magnitudes per dollar of loan amount, as opposed to guaranteed amount. To illustrate, in a $100,000 loan carrying a 90% SBA guarantee, $100,000 is the loan amount and $90,000 is the guarantee amount. Looking at cost per dollar of loan amount is especially important for policy analysis, as it gives a measure of the impact upon the small business sector and upon the economy for given amounts of governmental expenditure as important elements of program design such as fees and guaranty percentages are varied.

The analysis is in most respects the same as that in sections II-IV, except that costs and income are expressed in terms of cents per dollar of loan rather than cents per dollar of guaranteed amount.

TABLE 5

Effect of lowering percentage guaranty to 70% upon Net Cost Per Dollar of Guaranteed Amount

Fee	Net Cost
	¢
1%	8.17
3%	6.17
5%	4.17

As Table 6 shows, net cost declines to 8.31¢ per dollar. If fees are raised to 3 or 5 percent, cost per dollar declines to 6.55¢ and 4.79¢ respectively. These costs are about 12% below the corresponding costs per dollar of guaranteed amount, as total loan amount is 12% greater on average than guaranteed amount.

VI. EFFECT OF LOWERING GUARANTY PERCENTAGE ON COST PER LOAN DOLLAR

Lowering the guaranty percentage has both a direct and an indirect effect upon cost per loan dollar. The direct effect is that the ultimate loss rate falls because the percentage guaranty of the typical loan is 70% rather than 88%. Secondly, as explained above in Section III, it is assumed in this analysis that the ultimate loss rate falls by an additional 16.3%, based upon both theoretical expectation and empirical observation.

The present value of the ultimate loss rate falls by 1/3, from 6.86¢ per dollar to 4.57¢. Approximately 60% of this change is due to the direct effect and 40%, to the indirect effect.

The present value of net program cost falls to 6.2¢ per dollar with the current one percent fee, to 4.8¢ with a 3% fee and to 3.4¢ with a 5% fee. (Table 7)

VII. SAVINGS IN BUDGET AUTHORITY AND OUTLAYS

The present value of budget authority and outlay savings can be calculated directly from the tables. For example, the savings per dollar of loan amount that can be realized by switching from the current policy to a 70% guaranty rate and 5% fee are as follows:

Net Program Cost per loan dollar under current policy (Table 6)	8.31¢
Less Net Program cost per loan dollar with 5% fee and 70% guaranty (Table 7)	-3.40¢
Savings	4.91¢

The savings are 4.91¢ per loan dollar or $49,100,000 per billion dollars in loans. The actual year by year outlay savings can be calculated by converting back from present value to undiscounted dollars.

TABLE 6

Income and Expenses Compared to Loan Amounts

Income and Expenses	Present Value per dollar of Loan Amount (¢)
Income	
Guaranty Fee	.88
Direct Expenses	
Salaries and Administrative	.37
Portfolio Management	1.56
Indirect Expenses	.40
Ultimate Loss	6.86
Net Income or (Program Cost)	(8.31)
With 3% fee	(6.55)
With 5% fee	(4.79)

Note: The average guaranty percentage in the 7(a) guaranteed loan program is 88%. Therefore, a 1% fee, per dollar of loan amount, equals .88¢.

TABLE 7

Income and Expenses Compared to Loan Amounts with 70% guaranty

Income and Expenses	Present Value per dollar of Loan Amount (¢)
Income guaranty fee	.70
Direct Expenses	
Salaries and Administrative	.37
Portfolio Management	1.56
Indirect Expenses	0.40
Ultimate Loss	4.57
Net Income or (Program Cost)	(6.20)
With 3% fee	(4.80)
With 5% fee	(3.40)

Senator LEVIN. You have indicated that you view it as your function to be an advocate for the Administration's position. And I do not think there would be too much difference with that once the Administration has reached a conclusion as to what its position is. But prior to its reaching that conclusion in a budget, I take it many administrators and many Cabinet Secretaries argue for strong positions for their own agencies.

My question is, in your request, your budget request to OMB, wherein did you differ in any significant way from where their budget requests came out, or their budget to the Congress came out?

Mr. HEATHERLY. This year, Senator, we were in a very——

Senator LEVIN. I am talking about this year.

Mr. HEATHERLY. Yes, I understand. That is the only experience I have any knowledge of, is this year's process. This year was an unusual situation, in that we skipped the first stage of the normal process, which occurs in June or July, in which Agencies are given a target, a rough target, and then their submission is not bound by that. But they know what OMB and the White House is aiming at.

We did not do that. We started in the middle of the process. We followed more of an informal negotiation back and forth where we would narrow the differences, before the official submission, before the official request.

Senator LEVIN. Prior to that initial request, after the differences were narrowed, wherein did you have any significant difference from what is in the budget of the Administration?

Mr. HEATHERLY. I would have to go through item for item, Senator, and pick them out.

Senator LEVIN. Do any strike your memory?

Mr. HEATHERLY. We did not initially propose as great a reduction in the MESBIC funding as was in the passback. We did not initially propose reduction in all of the direct loans in our initial discussions. I believe we would have, and probably did have in mind, a greater transfer of the MBDA to the SBA more of a wholesale transfer without reductions.

A few of those cases, in S&E programs, we did request funding for upgrading our computer system, a multi-million dollar investment in fiscal year 1988, in the new hardware, a new mainframe computer. That has been agreed to in principle, but subject to finishing the technical analysis and requirement study. So the dollars are not in the budget per se. There were areas like that where we felt we needed to make some long range commitments and investments that are still pending.

Senator LEVIN. How about asset sales? Did you take a position on asset sales that was different from what is now in the budget of the Administration?

Mr. HEATHERLY. We did not make, to the best of my recollection, and I will maybe defer to Ed on this, I do not think we proposed a specific dollar on asset sales.

Senator LEVIN. Not a specific dollar. Did you propose there be asset sales?

Mr. HEATHERLY. Asset sales were being discussed and were at the time, in August, September, were still possibilities in the appropriation of the fiscal year 1987 appropriations.

Senator LEVIN. I am talking about the 1988 budget.

Mr. HEATHERLY. I know. We took it as a given. My answer is we took it as a given that there were going to be some asset sale proposals in the budget and we were willing to proceed with that. But I do not think we proposed a specific dollar target.

Senator LEVIN. Did you take a position on the advisability of asset sales in the 1988 budget prior to the decision?

Mr. HEATHERLY. We were not opposed in principle to asset sales.

Senator LEVIN. My question is, did you, during those discussions and negotiations, before the official position was decided, did you take a position then on asset sales, the wisdom and desirability.

Mr. HEATHERLY. Wisdom and desirability? Not on wisdom and desirability. I think it is a matter of trade-offs on where you want to find savings.

Senator LEVIN. I am just saying did you. Your answer was no, you did not. Is that correct? I am not asking you do you now. I am asking you, did you then?

Mr. HEATHERLY. We did not oppose the concept of asset sales. We assumed that there were going to be some asset sales in the budget. We did not come up with specific dollar targets in our proposal.

Senator LEVIN. Did you do an analysis of asset sales as to what their yield would be?

Mr. HEATHERLY. We assumed, and have proceeded on that assumption, Senator, before actually proceeding with the sale of any loan portfolio, we will do a thorough and independent analysis of the value and marketing potential, which we have now launched, through an RFP to bring on board an independent financial advisor to tell us, to the best of his professional judgment, his or her professional judgment, what we can expect and what we should aim at, and what are the conditions, and so forth.

There were assumptions in last year's budget, which have been retained in the official submission for this year. They include earlier ballpark assumptions by OMB and the Agency, on likely discount rates. We did not revise those at that time, since we figured another ballpark figure would not really accomplish much. We simply said we were going to do a thorough analysis and come up with a proposal before the sales would proceed.

Senator LEVIN. Prior to making that assumption of what the discount rate would be, did you do that, or have that independent analysis made?

Mr. HEATHERLY. No, Senator. That is in process.

Senator LEVIN. Does it make any sense to reach your conclusion, or make an assumption as to what you can sell assets for prior to having a study made, so you can see whether your assumption is sensible or not? Why don't you just wait, and do it right?

Mr. HEATHERLY. We do intend to do it right, Senator.

Senator LEVIN. Why don't you do it right, before making the assumption?

Mr. HEATHERLY. A budget must be based on some assumptions and some targets. The savings are the revenues projected from the asset sales are ball park estimates, to offset what we might call our very large ball park deficits.

Senator LEVIN. It seems to me you are going at it backwards, frankly. And you are doir what I would think in past years you

would argue should not be done. You are making a very unbusinesslike decision. You are making a guess as to what asset sales will produce, and you do not know what they are going to produce. And instead of going ahead with an independent study first, getting the results, you just take a stab-in-the-dark, put it in your budget and go ahead. You did not object to that? You are supposed to be defending this Agency.

I think, as a defender of this Agency, at least internally, if you really were interested in defending the Agency, you would have insisted that there be some independent objective things like analysis as to what you are putting in your budget.

I only want to take one more minute, and ask you this question about the Handicap Loan Program.

Do you know whether or not, in the drop in the percentage of loans that have been approved, there has also been a drop in the percentage, in the approval percentage?

Mr. HEATHERLY. No, Senator, I do not know that. We can ascertain it for you.

Senator LEVIN. Would you find that out?

Mr. HEATHERLY. Yes.

Senator LEVIN. I would like to know the number of applications and the number of approvals over a period of time.

Mr. HEATHERLY. Over the last 2 or 3 years, would that be adequate?

Senator LEVIN. Yes.

[Material follows:]

NUMBER OF HANDICAPPED LOAN APPROVALS
FISCAL YEARS 1984 - 1986

(Dollars in Millions)

	FISCAL YEAR 1986	1985	1984
DIRECT AND IP			
Number	128	248	178
Dollars	14.4	23.6	16.4
GUARANTEED			
Number	7	5	6
SBA Dollars	1.0	.8	.5
TOTAL			
Number	135	253	184
SBA Dollars	15.5	24.5	16.9

Information regarding applications by program area is only retained on SBA's computer database for a ninety-day period; as a result, information regarding the number of handicapped-loan assistance applications received by SBA for this three-year period is not available.

Senator LEVIN. Senator Kasten.

Senator KASTEN. Thank you. I want to go back to this direct loan, guaranteed loan.

The change that is being recommended is that SBA get out of the direct loan business completely, and that the guaranteed loans go from 2 to 4 percent on the fee. Is that correct?

Mr. HEATHERLY. The total back to the Agency would be 4 percent. Three percent from the borrower and 1 percent from the bank, or lending institution.

Senator KASTEN. That is what I was going to ask. What is it right now, it is 3 and 1.

Mr. HEATHERLY. It is 2 now. The bank pays nothing. It is 2 percent to the borrower, from the borrower.

Senator KASTEN. Is there strong opposition out there, either from the lending institutions or your clients, the small business people? I have not heard much of a firestorm out there on these increases in fees. I just wanted to know, you answered Senator Levin's questions saying you did not look to see what the effect of that might be. Are we going to have more, or fewer loans, are we going to see some financial institutions that are willing to participate in a program now, but with a 1 percent added on, they might be less likely to participate?

Can you answer any of those questions for us?

Mr. HEATHERLY. Our best judgment, we certainly considered this at the time which it was being prepared, and I will ask Mr. Holloway to supplement my remarks.

We certainly did ask ourselves what would be the impact on the demand and on the banks, the lending institutions. It is our best judgment that the 1 percent fee can be absorbed, given the profitability of the guarantee program. Particularly to those institutions that are in the secondary markets. Approximately 40 percent of our current guarantee volume is now being sold in the secondary markets. During fiscal year 1986 this amounted to more than $900 million.

In terms of the low interest rates that we now have, and the economic situation in general, we do not feel that this is going to pose a burden on borrowers, considering the favorable repayment terms that are being offered under the guarantee program.

I would like Mr. Holloway to respond further in terms of the analysis that we did.

Senator KASTEN. Let me make one more comment, and he can respond to both.

It seems to me, and I am not sure how this Committee is going to end up, where we are going to come out, but it seems to me that it would make more sense, and we would have a better chance of getting out of the direct loan program if, at the time we get out of the direct loans, we do everything we can to make the guarantee program work. And it seems to me, just conceptually, that we are trying to get out of the guarantee, excuse me, get out of the direct loan business, and at the same time possibly restrict somewhat the participation in the guarantee side.

Mr. HEATHERLY. This was a concern Senator.

Senator KASTEN. That is really the question I have. If we are going to make it through and have support for getting rid of the

direct loans, you all ought to be doing everything you can to be able to guarantee the small business constituency that you have, and the Congress, that in fact we can switch from direct loans to guarantees and make it work, and we are going to like it. And we do not need, if you will, the direct loan program.

I am not sure that this proposal reaches that end, that goal. I would like for you to tell me I am absolutely wrong. But that is what I want you and Holloway or whatever, to discuss.

Mr. HEATHERLY. When we were considering higher fees and where to go on this issue of the loan fees, we were also looking, Senator, at the cost of the program, and the ultimate goal of self-sufficiency, which was embodied in the Senate Budget Committee Report last year. At the present loss rates of 12 to 13 percent for the guaranteed program—ultimate loss rates over the life of the portfolio—we would need a loan fee above 8 or 9 percent in order to cover our losses and overhead. We think an increase to 4 percent is a very small step toward self-sufficiency. We also think that the borrowers can and will afford it, and will continue to use this program.

I can not say that we have done a rigorous analysis and simulations to prove this to you. I will say we will continue to study it and try to document our belief that the program would not be undermined by this increase in fees. I will defer now to Mr. Holloway, and any remarks he would like to make.

Mr. HOLLOWAY. Senator, I believe that we are searching in all these issues for a very delicate balance point. And true, on the one hand, we are trying to take a look at increased revenues and cost reductions to help us deal with the deficit. And on the other hand, we are trying to keep the program operational.

It has been my experience, that to the small business person, who is our focus, that the most important thing is access and availability of money, more than price. And as Mr. Heatherly indicated earlier, in 1981 we were dealing with prime rates at around 18 to 20 percent. Now we are dealing with a prime rate of 7.5 percent. Well that 12 percent drop in interest rate is very large in terms of what it does to a business person's monthly payment, as compared with, as the example was used on $150,000 loan. If you have an extra 1 percent to the borrower, that affects his payment $21 a month. So it did appear reasonable to us in searching for that balance point. To, on the one hand try to raise money, and move toward a self-sustaining basis, and help with the deficit problem, while at the same time, maintaining access for the small business person to the term financing that is available through this program.

Senator KASTEN. I do not want to belabor the point. I think you understand what I am trying to get at. Some of us believe, and will be with you, and have in the past made statements saying we think it is proper for the Small Business Administration to get out of the direct loan business. I am not sure that that is going to be the consensus this year. But that has been my general feeling.

But you are going to make it harder for us, if, at the same time, you are making the guarantee program not quite as acceptable, not quite as attractive, not quite as usable. And the results of that could be what has happened in the past, and that is you do not get

out of the direct loan business either. Because we are not assured, and the small business constituency groups are nor assured that it is going to work well. And I hope we are not there. It is obviously going to be working with and meeting with a number of these constituency groups.

I see some of the financial people are coming, and this is a question that I hope will be directed to them. Or that they would volunteer. But it just seems to me it would be a shame, if, in the process of trying to bump these fees and save some money in the deficit, you lose an initiative which you may be able to win on getting out of the direct loan business. That is my point.

Mr. HEATHERLY. That is a fair point, Senator.

Senator KASTEN. That would be a shame if that is the way it is turning out. I do not know if that is the way it is, but we ought to look at that. And in the Committee we ought to take a serious look at what this means for the future of the guaranteed portion. Which I think all of us support very strongly. Thank you, Mr. Chairman.

Senator LEVIN. Senator Baucus.

Senator BAUCUS. Thank you. Mr. Heatherly, I was not here, and I know the Senators and you discussed some morale questions at the Agency. Also some budget questions, but I wanted you to know that I associate myself with the tone and intent of those questions when those concerns were raised here.

While you are here I have two areas I would like to get your reactions on very briefly.

First is, and I know it is a budget hearing, but you are here, so I am going to ask you a couple of other questions. The first has to do with the difficulties that small business people in this country have in exporting products, just generally. Just a word or two as to what could be done to help them out. A lot of small businessmen do not know what is available. A lot of paperwork, some of it is real, some of it is imaginary. But there is probably a fairly good market if there were more opportunities available. It is a frustration a lot of small businessmen face. What, very briefly, in your judgment is the core, or the heart of the solution?

Mr. HEATHERLY. This is something the Agency has wrestled with for several years, and I think we are making some progress on it, Senator.

I think the small business owner who has an interest in export is already two steps ahead. In other words, if he is consciously aware and interested in it, at least he can start to seek out information and assistance. One of the big problems we see is that many small manufacturers and small business people in non-manufacture, who may have export potential, simply have a psychological block.

Senator BAUCUS. We know the problem. What is the solution?

Mr. HEATHERLY. I think the solution in terms of SBA's role is that we have to be the broker, the facilitator, to make that person, to give that person access to the information and assistance that exists in the International Trade Administration, in the private market, through export trading companies, so that they can overcome those up front costs to the small company, in understanding what the market is and how to break into it. The licensing requirements, the foreign regulations that are involved, our entire international trade program in the Agency is devoted, not to duplicating

the services that exist in the other Federal agencies, but to providing the linkages for the small business community into access to those services. We stress information dissemination, through conferences, workshops, seminars, publications, to try to reach the small business person who has an interest, and to tell them where to go for assistance. Come to us and we will help link you up with both governmental agencies, whether it is international trade administration, or our own line of credit, export financing, whatever is available. But first there has to be that first step, someone says yes, I am interested, can you help. We think there are thousands of small manufacturers out there that have the potential, that are not even thinking about it because of the psychological blocks, well, I am too small to do it. And we can not, there is no magic solution, Senator. If I knew one thing that we could do that would open the door tomorrow to vastly expand its small business export, we would be doing it.

Senator BAUCUS. What is the one thing SBA could do that would be most helpful? Just one that is specific, that is concrete, that is not just smoke.

Mr. HEATHERLY. When I came in, and I first took a look at our International Trade Program, what I saw was a program that was totally preoccupied with trade missions. Six to eight, nine trade missions each year, which benefited a small number of companies that participated in the trade missions. I told the staff to reorient their thinking to larger markets, and not to try to run trade missions, but to support the trade missions that were being done by state and local chambers and trade associations. And to make those trade missions more effective, more successful for the small business participant.

Senator BAUCUS. Are you familiar with Japan's JETRO? Are you familiar with that?

Mr. HEATHERLY. No, sir.

Senator BAUCUS. That is an organization that Japan has for Japanese exports. It is privately funded and it is also publicly funded. It is very aggressive, and I must tell you that I run into a lot of JETRO people. I just see them, and they are promoting Japanese exports. You are not aware of the program. I was going to ask you your reaction to whether the United States should develop a similar program that is an export effort that is also privately funded. The theory being that private individuals have a, probably a better idea of how tc market and sell their products than does the Government.

Anyway, I encourage you to look into that. It is a very active Agency. And a very pervasive Agency in this country.

A second very general question, I am just curious what your reaction would be.

There was a flood in Montana last September. And FEMA came in, I must tell you, FEMA did one heck of a great job. I was very impressed with the strike force, if you will, of FEMA personnel that came in and worked immediately with local officials. Mayors, County Commissioners, and so forth, to help them find ways to get public assistance. Basically, it is grant assistance, to public entities, local governments, to help with the sewage systems that are out, the water systems that are out and the bridges and roads and so

forth. I was not as impressed, however with efforts to help individuals, as opposed to public entities. That is, lots of farmers and ranchers and individuals were at sea, no pun intended, in trying to figure out what programs were available, how to get some assistance, and so forth. I am just wondering if there is some way, maybe there is and I am just ignorant about it, of having a kind of a private FEMA where all of these programs are lumped together in one. So some kind of FEMA-like strike force, if you will can come in, and fly into the area, and locate and set up their telephone systems, and so forth. And help not only the County Commissioners, and the public entities, but also help the private people, in a non-redtape, bogged up, gummed up way. That is FEMA's coordinators, all those are together, to help public assistance.

Mr. HEATHERLY. We try, where we are involved, where there is a disaster declared that brings us into the picture, we try to work very, very closely with FEMA. We go in and set up a single center called a Disaster Assistance Center, where we share the same facilities. People come to one place. We coordinate together. We meet with local officials, local business leaders, the media, try to get the word out through the media about what the assistance is going to be.

Senator BAUCUS. I appreciate that. But I am not really asking what SBA tries to do. I am really asking, does it make sense for the Farmers Home Administration, SBA, whatever else there is, to somehow either work together or, you know, have separate agencies. We are talking about emergency disaster assistance. These people need help right away.

Mr. HEATHERLY. I understand the concept, Senator. I sincerely support the concept. But when you try to get three or four different agencies with their own laws, regulations, procedures and requirements, to work through just "one-stop-shopping" so to speak, it is extremely difficult. Because they are each responsible back to their own laws, regulations, committees, and so forth. And it would take an overhaul of the legislation for the programs to really merge those into one agency, one disaster assistance agency that met all the needs of the clients.

Senator BAUCUS. This is terribly confusing to a lot of folks. And a lot falls between the cracks. And more often than not, these people are not helped.

Second, they are not helped because a lot of it is loans. Whereas, public entities get grant assistance. I just tell you, in your remaining days, you could perform a real service if you could figure out some way to address that. Thank you.

Senator LEVIN. Mr. Heatherly, thank you for coming. Can you tell us when Senator Abdnor's nomination is going to come over here? We can not seem to find out.

Mr. HEATHERLY. I will tell you all that I know. Which is, it is on track. And as soon as the background work is done, the White House has promised very fast turnaround to get it up to the Hill. And as far as I know that could happen tomorrow or the next day. It could be next week, it could be 10 days. But it is imminent as far as I know, Senator.

Senator LEVIN. Thank you, Mr. Heatherly.

[Material follows:]

ENCLOSURE I

ANSWERS TO INTERROGATORIES

SUBMITTED TO

MR. CHARLES HEATHERLY, ACTING ADMINISTRATOR

U.S. SMALL BUSINESS ADMINISTRATION

BY

SENATOR DALE BUMPERS, CHAIRMAN

SENATE COMMITTEE ON SMALL BUSINESS

FEBRUARY 24, 1987

QUESTIONS FROM SENATOR DALE BUMPERS

Question

1. In your opinion, or in that of your legal counsel, does SBA have authority under existing law to implement the President's budget proposals with respect to: a) the guaranteed lending program; b) the SBIC program; c) the MESBIC program; d) the Small Business Development Center program. If your answer to any of the foregoing is in the affirmative, please give citations to the pertinent statutory sections.

Answer

a. Guaranteed Lending

(1) Asset sales - Yes - §5(b)(2) of Small Business Act.

(2) Consolidate guaranteed programs into three major programs - No.

(3) Increase guaranteed fee from 2 percent to 3 percent to the borrower plus 1 percent to be paid by the bank - No.

(4) Phase down guaranty percent from 90 percent to 75 percent by 1992 - No.

(5) Eliminate direct business lending - No.

(6) Provide generally the same level of funding for lending programs as for FY 1987 - Yes - § 20(Y) of the Small Business Act.

b. SBIC Program

(1) Decrease SBIC guarantee from 100 percent to 90 percent - No.

c. MESBIC Program

(1) Reduce MESBIC lending to $20 million - No.

d. SBDC Program

(1) Reduce statutory cap from $65 million to $45 million - No.

(2) Phase out Federal funding to SBDC's over five year period - No.

(3) Postpone funding new SBDC's until FY 1988 - Yes - § 21(a) of the Small Business Act.

Question

2. If your answer to any part of question 1 is in the affirmative, please state whether it is your intention to implement such proposals in the absence of specific authorization from Congress.

Answer

Yes, it is my intention to carry out the Administration's budget objectives to the extent permitted by law. We will, of course, engage in full and frank consultation with the Committee as we proceed.

Question

3. In the FY 1987 appropriation measure for Commerce, State, Justice, the Judiciary and Related Agencies, the Committee included, at my request, report language requiring SBA to conduct a major study of the cost and economic effectiveness of SBA lending programs, using IRS data where possible, to determine net effects on job creation and federal revenues. The Committee directed that this study be conducted by the Office of Finance and Investment, in cooperation with the Office of Advocacy, and funded by the Office of Advocacy's research budget.

   a. Is this study presently being conducted by the Division of Finance and Investment?

   b. Although conversations were held between Committee staff and the Administration with regard to a request for extension of time to complete the study, no formal request was actually made. Is it your intention to make such a request, or do you anticipate having the study completed by June 1, as contemplated by the Conference Report?

Answer

   a. The study is being jointly conducted by the Office of Advocacy and the Division of Finance and Investment.

   b. Detailed discussions regarding appropriate methodologies and available data have occurred both within SBA and with the IRS. A request has been made to the Internal Revenue Service regarding the availability and cost of several kinds of data. An answer is expected within three weeks. When the data difficulties are clarified, we will be able to report specifically on how much time will be required to perform the required study and what, if any, additional resources may be required. Given the analytical complexity of the questions involved, it is unlikely that the work will be completed by June 1st. Therefore, a formal request for extension of the June 1, 1987 deadline will be sent to the Appropriations Committee very shortly.

Question

4. Please state precisely the number of personnel who have moved from the Department of Education to SBA since March 1, 1986, For each such individual, state employee's civil service rank and grade, and indicate how many such individuals are political appointees under Schedule C.

Answer

Since March 1, 1986, nine individuals "moved" from the Department of Education to the Small Business Administration. The names of these individuals and their civil service rank and grade, are as follows:

Helen R. Bell	GS-9/9
Lisa E. Bell	GM-13/00
Patricia A. Casal	GS-14/00
Kurt R. Davis	GS-12/1
Harriet S. Fredman	GS-9/1
Linda B. Rule	GM-15/00
Jeanne M. Sclater	GM-15/00
Veronica E. Swinton	GS-5/1
Daniel M. Velluci	GM-15/00

Four of the above employees serve on Schedule C appointments. Two of these employees, Kurt Davis and Lisa Bell, are no longer at SBA. Five are career employees.

Question

5. Has the Minority Small Business and Capital Ownership Development office developed a plan for implementing the proposal to transfer the Minority Business Development Agency at the Department of Commerce to SBA? If not, when will a plan be completed? Will the effects of the transfer on current SBA employees be studied? Will ongoing programs and services offered by the MBD Centers be continued in minority communities without lapse during the transfer procedure?

Answer

MSB&COD is developing a plan for implementing the proposal to transfer the Minority Business Development Agency (MBDA) from the Department of Commerce to the Small Business Administration (SBA).

The functions of MBDA would be carried out at SBA under existing legislative authority contained in the Small Business Act and supplemented by a new Executive Order as needed. All of the essential functions of MBDA including all of the existing MBDA Centers, would be continued at SBA.

An Agency Task Force has been established to identify issues and tasks related to the transfer.

We will examine the impact of the MBDA transfer on current SBA employees when we know the specific positions that will be transferred from MBDA, and when new organization structure alternatives are fully explored. We will try to minimize adverse impact and will respect the rights of all employees. However, at this time, we do not anticipate any adverse effects on present MSB&COD employees.

It is our intention not to disrupt ongoing assistance programs offered by MBDA funded Minority Business Development Centers (MBDC). We are very sensitive to the need for continuity of assistance to our minority small business constituents and thus will do everything that we can to minimize disruptions of service. All active contractual agreements entered into by MBDA and in force at the time of the transfer shall be honored. This should act as a mitigating factor against a possibility of any significant lapse in service occurring during the transfer period.

Question

6. The investigation of your former Assistant Administrator for the Office of Congressional Affairs, Dick Nelson, has now been completed. Although the SBA Inspector General's investigative report suggests that Mr. Nelson violated the Anti-Lobbying statute in Title 18 of the U.S. Code by his efforts at promoting the legislation, the Justice Department found that his activities did not violate the statute. Is Mr. Nelson still employed by the SBA? Have you established any new policies concerning lobbying activities by SBA personnel?

Answers

1. Mr. Nelson is currently still employed by the Small Business Administration, but only in a Consultant's capacity.

2. Since Mr. Nelson's activities did not violate the law or agency regulations, we see no need for changes in agency policies on "lobbying." We do, however, see a need for greater restraint on the part of the Committee in requesting investigations of activities that are clearly not illegal. My thoughts on this matter are spelled out in the attached February 19, 1987 letter to the Chairman of the President's Council on Integrity and Efficiency.

Question

7. The Administration's budget submission contains a large number of proposals with respect to the financial program, and especially SBIC's, which seem to have little or no budget impact. Why were these legislative ideas submitted in the budget if they have no impact on outlays or revenues? Second, do you intend to draft legislation to be submitted to Congress on any of these proposals?

Answer

All legislative proposals were included as a part of our FY 1988 budget submission in order to consolidate all FY 1988 proposed items in a single document. Since this document acts as a prime vehicle for transmitting budgetary and other programmatic initiatives to Congress and other interested parties, the impact on budget authority and outlays of these initiatives was not a sole consideration in its formulation.

Draft legislation on all proposals requiring separate legislative action are presently being reviewed by the Office of Management and Budget. Upon clearance by them, we will forward copies to your Committee.

Question

8. If the COSBI bill is redrafted this year to take into account some of the Administration's objections last year, would SBA or the Administration as a whole support the bill? Will SBA participate, on behalf of the Administration, in discussions of this proposal?

Answer

The Administration's objections to the COSBI bill under consideration last year came from several directions. First, as set forth in SBA's testimony before the Senate and House Committees, specific objections to the bill focusing upon, in our opinion, serious weaknesses and potential problems.

Second, in separate letters, the Director of the Office of Management and Budget, and the Secretary of the Treasury also set forth some specific objections to COSBI and also expressed general opposition because COSBI, if created, would establish still another government supported enterprise.

SBA, on behalf of the Administration, will participate in any discussions on any newly drafted version of COSBI if requested to do so by the Congress and authorized to do so by the OMB. The Administration's support of a newly drafted COSBI bill hinges on satisfactory resolution of all the specific and general objections of the Administration as set forth in last year's testimony and correspondence to the Congress.

Question

9. In the budget proposal with respect to SBIC's, you propose creation of a new "90% guaranteed" species of security to replace the currently 100% SBA-guaranteed debentures which are currently sold in the private capital markets to finance the program. As such, this paper would carry the "partial faith and credit" of the United States.

   a. Is there any other security which is partially backed by the United States government?

   b. Did you hold discussions with investment bankers, prior to submission of this proposal to Congress, to ascertain how the financial markets would treat such securities?

   c. Did you hold any discussions, prior to submission of this proposal, with the SBIC industry to determine how SBIC's would be affected by it?

   d. What is your estimate of the added cost to the SBIC and, ultimately, the small business borrower from this new type of security?

Answer

   a. SBA has wide experience with the origination of 90% SBA guaranteed loans and the pooling and selling of the guaranteed portions of those loans, or certificates representing ownership of those loans, to the private capital markets. This program has been successful with the new sales volume reaching $938.9 million in 1986 .

   It is important to clarify at this point that the security sold under the above referenced existing program is 100% guaranteed by the full faith and credit of the United Stated in spite of the fact that the underlying small business loans are only 90 guaranteed. Because only the guaranteed portions are pooled, the securities backed by these pools are 100% guaranteed. The proposed new SBIC financing program would operate much the same, that is, it would use third party risk sharing for the unguaranteed 10% portion.

   b. SBA held no discussions with investment bankers prior to submission of this proposal to Congress. However, in connection with its implementation of the changes in the financing structure of the SBIC program already mandated by Congress, SBA has had extensive contact with investment bankers. It is our opinion that driven by the potential for fee income, they will be able to create an investment product that will well serve the purposes of the SBICs and will be well accepted in the investment markets. There is almost daily evidence in the financial press of the creativity and resourcefulness of the investment bankers in creating financing structures to facilitate the most complex financing needs.

c. SBA did not have any formal discussions with the SBIC industry prior to the submission of this proposal.

d. Until the actual marketing of such a new program, it is not possible to tell what, if any, added cost would be involved on this new program. Theoretically, the 90% guaranteed portion sold to the public markets would be priced using the same comparable securities now being used, and thus, everything else held constant, the costs would be the same. There would be added costs on only 10% of the borrowing and we estimate that the impact on total costs by the increase in costs of the 10% unguaranteed portion would be minimal with little or no net effect on the ability by the SBIC's to meet their funding needs.

Question

10. In the budget proposal with respect to Minority Enterprise Small Business Investment Companies (MESBIC's), you intend for part of the program to be financed through new guaranty authority within the regular SBIC program, which is now financed through the sale of 100% SBA-guaranteed debentures in the private capital markets. You have not specified whether these new MESBIC debentures would be 100% guaranteed or 90% guaranteed, as you have proposed for other issuances of SBIC debentures. Which would be the case?

Since this new guaranty authority for MESBIC debentures only amounts to $17 million over the course of a year, this may not be enough to economically justify a public offering of securities. What is your estimate of the added cost to the borrowers by creation of this new type of security; that is, how much above comparable Treasury paper or other SBIC paper would it cost the MESBIC industry? Do you contemplate a public offering or private placement of these securities? Do you contemplate a single, annual offering of these new MESBIC securities through SBIC Funding Corporation, or would the $17 million in authority be divided into quarterly offerings?

Answer

The proposals contemplate that the MESBIC debentures be 90% guaranteed and that their interest rates would be the same as those charged SBICs in connection with the guaranteed funding of their debentures.

SBA's actual proposal calls for $14.0 million of guarantee authority for MESBICs for FY 1988.

The added costs to the MESBICs for the first five years of the debentures would be equivalent to the difference between the subsidized rate they now enjoy, and the market determined rate that SBICs now pay. This would be 3% plus the differential that SBICs would pay over Treasury rates. The added costs for the second five years would be equivalent to the differential that SBICs pay over Treasury rates which is a market determined differential.

These would be publicly funded by including them in the periodic fundings of SBA-guaranteed SBIC debentures.

As stated above, the SBA-guaranteed MESBIC debentures would be funded along with the SBIC debentures on whatever frequency would be justified by the demand for funds.

Question

11. In your testimony, you referred to significantly lower "charge-off" rates for loans with an SBA guaranty percentage lower than 90% and, later in your testimony, to 1986 loan charge-offs of $308 million. First, is it possible that you intended "repurchases" rather than "charge-offs"? If not, please give your definition of these terms, as well as the details of any study which SBA has performed on this issue.

Answer

The SBA utilizes charge-off or loss rates to compare its various types of lending and its various lending programs. This statement referenced the results of an ad-hoc study of the loans charged-off between July 1974 and early 1985. The conclusion of this study was that during this period, the loss rate on loans in the 70-80% guarantee category was 4.27% compared to a loss rate on loans in the 90% guarantee category of 5.101%. This difference, .831%, equates to a 16.3% lower loss rate on loans in the 70-80% guarantee category.

This computed difference was then applied to actual FY 1986 charge-offs on guaranteed loans of $308 million, to arrive at a $50 million estimated annual savings in charged-off loans as a result of lowering the guarantee percentage.

Question

12. In regard to the proposed elimination of direct lending programs for Veterans and the Handicapped, would the Administration support creation of a new guaranteed lending program, with a 100% guaranty and with subsidized interest paid by SBA to the conventional lender in order to meet the needs of these two specially disadvantaged groups, assuming such a program would be scored as creating budget savings?

Answer

No, the Administration would not support such a proposal. First, we take issue with the assumption that such a program could be scored as creating budget savings. If properly measured, it would take an equal amount of budget authority under either method to subsidize rates down to a given level. Second, it would be expensive to administer such a complex program particularly at very small program levels. Third, a 100% guaranty is contrary to Administration's announced government credit policy.

The current budget proposal should not cause a significant decrease in lending to veterans. In 1986, veterans received twenty-two percent of SBA loan dollars, and ninety-six percent of those dollars came in the form of guaranteed loans. Since guaranteed lending is such an overwhelming percentage of total lending to veterans, we do not believe that the termination of direct loans will have any substantial effect on their access to credit.

One of the recurring themes in the history of the SBA business loan program is the continuing and ever-increasing involvement of the private sector--in particular the lending community. From the beginning of the agency private sector lenders were involved in the loan programs, although in the early years the emphasis was on direct loans from the SBA. In 1954--the first year of operation--guaranteed loans accounted for only 48% of the $23.1 million in SBA loan dollars. This percentage quickly fell ranging from 8 to 17 percent in the years from 1955 through 1965. Guaranteed loans suddenly jumped to 43% of total volume in 1966 and from 1972 through the present has varied between 92 and 98 percent of the total. In FY 1987 only $58 million has been appropriated for 7(a) direct loans, compared to $2.5 billion for 7(a) guaranty loans.

Under the budget proposal all direct business loan authority, except for MESBICs, would be eliminated. This change would have benefits both for the borrower and the taxpayer.

For the borrower it would mean that all SBA general business loans would be made through banks. For small businesses, borrowing from a bank instead of from the SBA means they can develop a relationship and a track record with a private sector lender rather than with a government agency. As one of the purposes of the SBA program is to foster the long term growth of individual small businesses, we can do this better by facilitating a relationship with the major private sector institutional provider of credit to small business than by enabling small businesses to become dependent on financing from the government. Guaranteed loans also permit small businesses to borrower greater amounts of money: $500,000 (SBA share) and more with a guaranteed loan versus $150,000 with a direct. Interest rates are similar. In mid-December of 1986 the direct loan rate was 8.25. The legal maximum rate on guaranty loans was 9.75% on loans of seven years maturity and less and 10.25% on those with a greater maturity. Many guaranty loans are made at less than the legal maximum. Rates on Handicapped Assistance Loans, currently set statutorily at 3%, would rise more substantially.

For the taxpayer, guaranteed loans are preferable to direct because they cost less. In the short run they require an outlay of Federal funds only when an incurred default occurs and SBA must purchase the loan from a bank, whereas a direct loan requires an outlay of government funds each time a loan is made. In the long run, the cost of each program is best measured by the loss rate--net charge-offs divided by total disbursements-- and the loss rate on guaranteed loans is less than it is on direct.

Also of interest to the taxpayer is cost of administration. Direct loans are serviced by SBA; guaranteed loans, by the lender. During the past several years SBA has moved to turn very more of the responsibility and cost of program administration to the private sector through such programs as Certified and Preferred Lender, where experienced and active SBA lenders assume more of the responsibility for making the credit decision. This approach bears added benefits for the loss rate as well, since such lenders tend to make better loans. In addition, lenders are assuming ever more of the responsibility for liquidation activity, further reducing operating cost to the government.

The history of the SBA business loan programs has been one of development from the small, simple direct loan program of the 1950's to the sophisticated public-private partnership of the 80's. Elimination of direct loan authority will permit SBA's limited resources to be focused on areas generating the greatest benefits to the Nation's small business.

ENCLOSURE II

ANSWERS TO QUESTIONS

SUBMITTED TO

MR. CHARLES HEATHERLY, .ACTING ADMINISTRATOR

SMALL BUSINESS ADMINISTRATION

BY

SENATOR LOWELL P. WEICKER, JR., MEMBER

SENATE COMMITTEE ON SMALL BUSINESS

FEBRUARY 27, 1987

QUESTIONS FROM SENATOR LOWELL WEICKER, JR.

Question

1. Public Law 99-500, the Continuing Appropriations Act for FY 1987, authorized in report language ten full-time Veterans Affairs Officers (VAO's) to be placed in SBA regional offices. You acknowledge in your written testimony that you have complied with the law by designating those full-time positions. Yet, in this budget submission the Administration would eliminate direct funding for veterans, an essential component of the Veterans Program, in my judgment. You seem to suggest that you support the Veterans Program by your testimony, yet you recommend abolishing an important part of the Veterans Program at SBA. How do you explain that?

   Following a meeting requested late last year by SBA with staff and representatives of Veterans organizations, it was explained that the 10 Regional VAO's would report directly to the Veterans Affairs Office in Washington, and that the Veterans program office in Washington, would report directly to the Office of the Administrator. Please explain how you have implemented the Veterans Affairs program pursuant to P.L. 99-500.

Answer

SBA is a decentralized agency with program delivery being the responsibility of Regional and Local offices. This form of organization has served the small business community well in all program areas.

In order to meet the spirit and intent of the law, we have assigned the 10 Regional Veteran Affairs to the Regional Administrators for day-to-day supervision with technical and program guidance being provided by the Veterans Affairs office in Washington.

The Veterans Affairs Office in Washington has never reported directly to the Office of the Administrator and we know of no discussions or plans for that to be done. We are not aware of any public meetings where this issue has been proposed or promised.

Only the direct loans to Veterans, relatively small portion of overall loan assistance provided to Veterans, are proposed to be eliminated. All the business financing assistance needs of our Veterans are expected to be more than adequately met through the SBA's guaranteed loan program.

Question

2. Mr. Heatherly, as you know, Public Law 99-272 changed the method of financing for the Small Business Investment Company (SBIC) program by providing that debentures be sold to private capital markets rather than to the Federal Financing bank (FEB). Your testimony points out that there have been two successful financing under this approach. The success of this approach is borne out by the fact that the second financing was 80 basis points less than the initial sale. the law provides that the debentures and the pooled certificates carry the full faith and credit guarantee of the government, e.g., a 100% guarantee. Why do you now propose reducing the SBIC guarantee to 90%?

   a. What effect would this proposal have on the cost of borrowing for the SBIC licensees and in turn the small business borrowers? How would this 90% guarantee financing be structured?

   b. did you confer with SBIC program personnel in developing this proposal? Did you confer with the SBIC industry about the possible impact of this proposal on the program?

   c. Who did you consult with about the impact of this proposal on the program?

Answer

Section 303 of the small business investment Act of 1958, as amended, (Act) does not specify any mandatory percentage of SBA guarantee. It states instead that "Such purchases and guarantees may be made by the Administration on such terms and conditions as it deems appropriate, pursuant to regulations issued by the Administration." The new Section 321 of the Act created by COBRA does not address the issue of the percentage of SBA's guarantee on debentures which make up pools of debentures against which certificates authorized by that Section are issued. The pools could be composed of the 90% guaranteed portions of SBIC debentures, with the 10% being held by third parties.

This Administration in OMB circular A-70 clearly sets forth its policies and guidelines for Federal Credit programs. This proposal of SBA implements that policy and those guidelines. One of the stated purposes of that circular is to encourage recourse to individuals and private financial institutions as the primary source of credit.

The OMB's principles of Federal credit policy and the standards for their implementation require a significant sharing by private lenders of risk of loss from a default. Sharing of 20% of the risk of default is considered significant. SBA's proposal for a 10% risk sharing is below that OMB guideline because of the higher risk nature of the SBIC program.

In answer to the other points raised in this interrogatory:

a. Until the actual marketing of such a new program, it is not possible to tell what, if any, added cost would be involved on this new program. The changes mandated by the Congress under the COBRA legislation of 1986 suffered from the same uncertainty as to added costs. Theoretically, the 90% guaranteed portion sold to the public markets through the guaranteed portion sold to the public markets through the pooling method would be priced using the same comparable securities now being used, and thus, everything else held constant, the costs would be the same. There would be added costs on only 10% of the borrowing and we estimate that the impact on total costs of the increase in costs of the 10% unguaranteed portion would not prohibitive. The actual debenture would bear a rate which would blend these proportionate risk differences.

   Although SBA has held no specific discussions on these issues with investment bankers prior to submission of the budget proposal to Congress, SBA has had extensive contact with investment bankers in connection with its implementation of the changes mandated by Congress in the financing structure of the SBIC program. It is our opinion that driven by the potential for fee income, the investment bankers will be able to create an investment structure that will efficiently serve the purposes of the SBIC program.

b. These proposals were discussed with the SBIC program policy making personnel at SBA to the extent necessary. However, to the great extent these proposals were formulated to conform with the Administration's Policies and Guidelines for Federal Credit Programs as set forth in OMB Circular A-70.

   We did not confer with the SBIC industry about possible impact of this proposal on the program. However, we believe the industry was well aware of the probable impact of A-70 on the SBIC program. This proposal is not a surprise to the industry.

c. As indicated previously, these proposals were discussed with the SBIC program and other policy making personnel at SBA to the extent necessary.

Question

3. The budget proposal would reduce MESBIC direct financing by $19 million, almost 50% below the current level. It would create a new MESBIC guarantee loan program. How would this guarantee program work

   a. Would MESBIC financing be a part of future public sales of SBIC debentures or would it be a separate issue only for MESBICs?

   b. What would the costs be to the MESBIC program for its financing under this approach? Would you expect this approach to cost the MESBIC licensees more than is currently charged under the law? What effect do you think this will have on the program?

   c. Would the financing for the new MESBIC guarantee program have a 100% guarantee on debentures or would the guarantee for that program be reduced to 90% as you propose for the SBIC program?

Answer

The MESBIC debentures would be 90% guaranteed by SBA and would carry terms and conditions, including interest rates identical to those of SBIC guaranteed debentures.

a. As indicated above, the MESBIC debentures would be funded using the same pooling system now used by SBICs and integrated into the periodic pools now formed by SBICs in the public fundings.

b. The added costs to the MESBICs for the first five years of the debentures would be equivalent to the difference between the subsidized rate they now enjoy, and the market determined rate that SBICs now pay. This would be 3% plus the differential that the SBICs would pay over Treasury rates. The added costs for the second five years would be equivalent to the differential that the SBICs pay over Treasury rates which is a market determined differential.

   The MESBICs have a permissible interest rate spread that we consider more than adequate to absorb any increase in the cost of funds if prudent and efficient management practices are followed. Further, since these changes would take effect slowly, MESBICs would have ample time to change their business practices to adjust for any adverse effects.

c. The MESBIC debentures would be 90% guaranteed by SBA and would carry terms and conditions, including interest rates identical to those of SBIC guaranteed debentures.

Question

4. In a letter from Ms. Carol Crawford of OMB dated December, 1985 to Jim Sanders, the former SBA Administrator, it says that no new program initiatives were to be developed in 1986. On page 2 it states, "activities designed to increase awareness of SBA programs and to market SBA should stop immediately." Is this memo, which was a part of the passback on the FY 1987 budget proposal, still in effect? Have you taken any steps to formally rescind this directive? What are your instructions this year with respect to promoting SBA programs to the public?

Answer

The instructions from OMB to Jim Sanders direction that "activities designed to increase awareness of SBA programs and to market SBA should stop immediately" were, as the question states, part of the FY 1987 budget passback. Those instructions, were issued in conjunction with then submitted Administration's proposal to transfer SBA to the Department of Commerce.

As you know, the President's FY 1988 Budget proposal supports the continuation of the SBA as an independent agency. Furthermore, in mid-August 1986, the President announced that he was committed to an independent SBA. The directions I have given to SBA staff this year have been in full support of the President's position on the future of the SBA and to communicate clearly to the small business community what resources are available to them.

An active program to promote both small business and the Agency's programs has been started. It involves production and airing of public service advertising, production of radio news programs, increased use of print media through improved quality of news releases, increased emphasis on seeking opportunities for media interviews on television and radio talk shows and news programs and establishment of SBA Speakers Bureau. This is in addition to the currently ongoing public awareness activities, such as Small Business Week, Minority Enterprise Development Week, recognition of outstanding Entrepreneurs, etc. Assistance in these endeavors is being obtained from a Public Communications Advisory Board which is comprised of representatives from both Congressional Small Business Committees in addition to representatives from trade and business associations.

Question

5. What have you done to promote the SBA 7(a) guaranteed loan program to the banks and other lenders? Many lenders are still confused as to the status of SBA's financial assistance programs.

Answer

The Administration proposed to terminate the 7(a) guaranteed loan program in its 1986 and 1987 budget proposals. the program was not marketed during this period, since it was assumed that it would be terminated at the end of each year. It would have been inappropriate for SBA to try to sell a program that had been proposed for elimination.

However, since the Administration's reversal of its position the SBA has been actively promoting this program through visits of individual lending establishments by our field personnel and briefing of their loan officers during these visits. In addition, I have always requested that representatives of the banking sector be invited and included in public arenas where I have spoken in recent months -- in Los Angeles, Minneapolis, Denver, and elsewhere. All of our Regional Advisory Councils include bankers in their memberships and our field staff communicate very regularly with all of our participating installations.

Question

6. What have you done to promote the Secondary Market program? has SBA sponsored any sessions with bankers and investors to advise them that this market is available and could be more effectively utilized?

Answer

During the final stages of development of the pooling program, SBA co-sponsored four seminars with the Bank Administration Institute describing the new program. Attendance by approximately 500 people exceeded our expectations. These meetings provided a brief description of the SBA lending program, the secondary market for SBA guaranteed loans and a description of the new pooling program. These seminars were held in Washington, D.C., Chicago, San Francisco, and Dallas.

The Secondary market Program Guide is in process of being revised. This guide is a complete reference on the SBA secondary market. It contains all necessary forms as well as an explanation of the market. With over a year of experience in the pooling program, we are now in the position to review operating procedures and revise them as necessary. We expect the revised guide to be available within three months.

The Tripartite Agreement, SBA form 1086, is also being revised and could be used as an outreach document. The new form contains not only the agreements between the lender, investor and SBA, but also provides a sample form and instructions for providing the required information to the fiscal and transfer agent.

Also, SBA has been making its staff and management personnel available for trade association meetings to explain this program. During the past two years, SBA has had at least two representative at each meeting of the PSA and NAGGL. SBA staff have addressed these groups, taken questions from the podium, and taken questions individually while at the meeting site.

Question

7. The President's budget calls for the transfer of the Minority Business Development Agency (MBDA) in the Department of Commerce to the SBA. the principal program at MBDA is the Minority Business Development Center (MBDC) program. How does the Administration plan to execute this transfer legislatively or administratively?

In 1984, the commerce Department's Inspector General issued a report questioning the effectiveness of the MBDC program, stating that many of its reported accomplishments were overstated and misleading. Will the MBDC program simply be layered into SBA or do you intend to restructure the management assistance component of MSB/COD with these additional resources?

Answer

The transfer will probably be executed administratively by Executive Order, although a final decision on this has not been made.

We have not seen the Department of Commerce 1984 Inspector General's report on the effectiveness of the MBDC program. We have requested a copy of the report. When we receive it, we will study it carefully, and use the report as a basis for making any necessary corrections or improvements to the MBDC program.

It is our intention to honor all contractual agreements MBDA has with its MBDCs at the time of transfer. However, eventually, we intend to determine which types of M&TA can be best delivered by 7(j) providers; which by MBDCs; how and if these services can be integrated; and take steps as necessary to optimize program delivery.

Question

8. Historically, the 8(a) pilot program has been plagued with slow starts and problematic beginnings. P.L. 99-567 reauthorizes the program for 2 years from October 86 to September 20, 1988. We have already lost nearly 6 months. In view of valuable time lost in naming an agency, what plans has SBA made to get the pilot program off to a good start when an agency is announced? Do you feel you will have sufficient time to plan, implement and formulate conclusions this time around having lost 6 or more months by the time the program gets going?

   a. What were the accomplishments during the past pilot program with DOT as procuring agency?

   b. What was the final number and dollar amount of contracts set aside for the program?

   c. Did SBA effectively utilize its additional authority to select procurements? If you answer is yes, how?

Answer

The SBA office of MSB$COD has formed a four-member task force, consisting of senior persons from headquarters and field offices to refine procedures to facilitate the implementation of the 8(a) Pilot Program. The task force will convene its initial-meeting on March 24.

We candidly admit that the delay in the designation of a Pilot Agency, has delayed implementation of the Program. Furthermore, major changes in administrative methodology of this program appear to be in order. In the past the Pilot Program was administered on a centralized basis with relative lack of success. Now, it is proposed that the current Pilot Program be operated on a decentralized basis with a broader spectrum of contracting opportunities. This introduces a requirement to develop more detailed procedures essential for effective implementation and then monitoring of such a decentralized Pilot Program.

Ideally, it would be desirable to have a 60 to 90 day lead time to plan for Pilot Program implementation. Under the circumstances, however, it is recognized that ample lead time may not always be available. We are confident, though, that the concepts that have been already developed for Pilot Program implementation can be formalized into effective Pilot Program procedures within a reasonable period of time (30 days).

There were 14 technically sophisticated, high dollar volume, long-term contracts with an approximate value of $230.5 million (including options) selected for award under the most recently completed Pilot Program with the Department of Transportation. the actual dollar-value awarded to date has been $49 million (excluding options). A total of 13 projects were actually awarded under the Pilot Program, and one was withdrawn.

The question whether SBA did effectively utilize its additional authority to select procurements under the past pilot program can not reasonably be answered by "yes" or "no". It was definitely "no" on the basis of expectations, but still, $49 million in contracts, which otherwise would not have been awarded to the 8(a) firms, were obtained.

Therefore, we believe that the stated objective of the Pilot Program to bring into the 8(a) program non-traditional, high-technology, long-term, high dollar contracts volume was achieved.

Question

9. SBA has never fully implemented the Surety Bond Waiver Pilot program since the program was initially authorized in 1978. What plans do you have to fully test this pilot program this time around?

Answer

The responsibility for implementing the Surety Bond Waiver Pilot has been transferred from the Agency's Surety Bond Guarantee Program in our Finance and Investment Office, to the Office of the AA/MSB&COD. The Office of the AA/MSB&COD is presently engaged in determining the most reasonable approach to full test the waiver provisions.

Presently the feasibility of expanding the parameters of the current regulations so as to open the program to the needy 8(a) certified construction contractors is under consideration. Additionally, it has been proposed that management and technical assistance, provided by a qualified construction management firm, be a requirement to obtain Surety Bond Waiver. SBA is considering providing such M&TA via Section 7(j) of the Small Business Act on a shared cost basis. We are also looking into establishment of a loss reserve.

Resolution of these remaining issues is progressing satisfactorily. We anticipate the completion of the development of then programmatic details during the month of April of this year. Thus, we are certain that we will be able to adequately test the Surety Bond Waiver Pilot in a manner to demonstrate its appropriateness or inappropriateness as a business development tool for the 8(a) certified construction contractors.

Question

10. Your testimony and the Budget submission indicates that in FY '87 SBA projects receipts of $277 million from the sale of disaster loans. The President's budget proposal from last year proposed selling SBA loans. Although the Congress approved a pilot program to sell $6 billion of loans as a way of testing the concept, the reconciliation bill did not include SBA loan asset sales. You mention that SBA has issued an RFP for a financial advisor. Does SBA intend to go forward in FY '87 with the sale of assets without Congressional guidance?

Answer

SBA is in the process of hiring a financial advisor to provide SBA with guidance on the saleability of the disaster loan portfolio as well as the entire direct loan portfolio. The FY 88 Congressional budget submitted earlier this year calls for receipts of $277 million from asset sales in FY 87, SBA staff must be prepared. The work done to date on the asset sale project is of a preliminary nature.

The procurement process is long and sometimes unpredictable. In order to insure that financial advice would be available if and when it may be required, the decision was made to hire a financial advisor now. The RFP for the financial advisor does not contemplate that the successful bidder will conduct a sale. If such a decision is made, SBA would hire a different contractor to act as an underwriter.

Question

11. You state that the Administration's proposal on Federal Credit will be released in March and at that time you will be happy to discuss with us the impact of asset sales on credit programs. Since you apparently plan to go forward with the sale, can you tell the Committee how much it will cost the Government five years from now to run the disaster loan program at current levels if we sell $1.5 billion of the loans in the portfolio in Fiscal Year 1987-88.

Answer

The budget proposal although not specifically addressing it, includes the eventual sale of the entire Disaster portfolio over the period FY 1987-FY 1992. Obviously, the sale of assets greatly impacts the revenue flow into the fund. The magnitude of the impact on the early years is directly related to the class of loans that are sold. If the sale of assets is evenly spread over the time period and SBA is allowed to retain the receipts from the sale of assets in the Disaster fund, these receipts along with the current balance will be more than sufficient to cover all anticipated expenses of operating at a current level through FY 1992. However, if SBA must continually transfer carry-over balances to the Treasury, or the sale of assets is handled in such a manner that all income-producing assets are sold in the first years, then the fund would require future appropriations to cover operating expenses.

Question

12. Your budget calls for the phasing out of funding for most Small Businesses Development Centers (SBDCs) in three years, and for the entire program in five years. As you know, this is a 50/50 federal match program. Many states have said they would terminate their SBDC if SBA did not continue to match state resources. If that is the case, how does SBA intend to provide the diversified management and technical services Congress found so necessary for small businesses?

Answer

The budget proposal includes the phasing out of the Federal funding of the SBDC program over the next five years.

The Small Business Development Centers have shown that they are able to leverage beyond the original expectation of Congress having reached a 1.4:1 ration nationally compared to a planned leverage factor of 1:1.

The SBDCs have also expanded their service beyond being a resource for this Agency. They have been able to obtain support through contracts and other types of agreements with other Federal, State and local agencies and the private sector. This type of support will continue after the SBA funding is phased out.

The Small Business Administration's is fortunate to have resources beyond the Small Business Development Centers to deliver quality management and technical assistance.

Our Senior Corps of Retired Executives (SCORE) performs one on one counseling to small business clients and they conduct prebusiness workshops as well as training seminars. SCORE is made up of over 12,000 retired executives in more than 400 chapters nationwide, having experience in just every field imaginable. SCORE members volunteer their time and talents with SBA underwriting travel and national office support. The Agency intends to expand this low cost service through wider recruitment efforts.

Also available to SBA, under our "for-profit" law, are joint co-sponsorships with corporations that want to support small business. We are finding that there is a vast amount of support ready to assist in helping small business in training and counseling activities.

Our Small Business Institute program will also continue. This program involving post graduate and graduate students in over 500 universities nationwide assists small business on an individual basis.

Although the SBDCs are expected to continue to play a role in assisting small business through the support of the individual states and contracting services to other entities, we believe that our other resources mentioned above will continue to assist small business and will expand their services when and where the need exists at a lower cost than the SBDC program.

Question

13. Mr. Heatherly, in eliminating the SBA Pollution Control Financing program as the Administration proposes, doesn't that leave direct appropriations as the only alternative to servicing the program's debt service?

Answer

The prime revenue source to the Pollution fund had been the guarantee fee on new pollution bonds. Over the last few years, these receipts have dwindled because of the lack of new pollution bond guarantees. This has required us to request direct appropriations to cover anticipated operating expenses. In FY 1986, these guarantee fees only amounted to $1.4 million in revenues to the fund. If the Pollution Control Bond program is eliminated, based on FY 1986 receipts, it would have the impact of requiring about an additional $1.4 million in direct appropriations per annum.

Question

14. In examining the Pollution Control Financing program, hasn't the SBA's enhanced credit standards resulted in no new defaults on guarantees issued since 1984?

-- Wouldn't the retention of the program's director and part time analyst, which is the entire program staff, seem a small expense in allowing the program to service its own liquidated debts rather than rely solely on appropriations?

Answer

There have been no defaults on guarantees issued since 1984, but those are too recent and few in number to provide a statistically accurate default rate.

Using FY 1986 figures of 14 approvals, the average guarantee approved was $1.8 million, which would produce approximate income from guarantee fees of 3.5 percent of the aggregate or $167,000, and administrative fees of $14,000, totaling $181,000 per guarantee. Were we, however, to assume that no further defaults will occur, an increased annual volume of new guarantees of approximately 600% of the volume attained in FY 1986 would be required to produce fee income equal to present annual claims payments. During the first five months of FY 1987, only one new guarantee for $5 million of principal was issued while 6 new defaults involving principal of $6.3 million were recorded. In our view, it is highly unlikely that the underwriting results and volume levels to support the premise underlying this question can be attained. The slack program volume during the past five years leads us to believe that falling interest rates have opened up other viable sources of financing small business pollution abatement.

ENCLOSURE III

ANSWERS TO QUESTIONS

SUBMITTED TO

MR. CHARLES HEATHERLY, ACTING ADMINISTRATOR

U.S. SMALL BUSINESS ADMINISTRATION

BY

SENATOR ALAN DIXON, MEMBER

SENATE COMMITTEE ON SMALL BUSINESS

FEBRUARY 24, 1987

QUESTIONS FROM SENATOR ALAN DIXON

Question

1. In 1985, the Small Business Development Centers in Illinois counseled approximately 12,200 small business owners through general information and, short term and long term counseling. Approximately 700 programs were held with about 17,525 attendees. These services are obviously of need and use in Illinois and yet your FY 1988 budget recommends the phasing out of federal funding for these programs and the elimination of funding for any future SBDC's.

   a. What alternatives would you provide for the small business owners in Illinois?

   b. Where are they to turn for management assistance that meets their specialized needs?

   c. Isn't the state of Illinois already providing funding to match the federal contribution? Would you have them increase their level of funding to compensate for the federal government again withdrawing support from the less fortunate, in this case, the Small Business community?

Answer

The budget proposal does not discontinue the Small Business Development Centers but rather phases out the federal funding of that program.

We believe that alternative funding can be obtained through the use of realistic user fees, local government involvement and private sector support in addition to the current level of state support.

It should also be pointed out that SBA will continue the support of the Senior Corps of Retired Executives (SCORE) to provide management assistance to small businesses through their counseling and training activities. This program has been very successful and is a low cost program.

With the level of support being provided by SCORE and continued support by state and local interests of the SBDC program, there will not be a reduction of services to the small business community.

Question

2. According to the 1984 Handbook for Small Business, "the mission of the SBA is to help people to get into business, help them stay in business, help small firms win federal procurement, and to act as a strong advocate for small business."

   a. Given this current budget proposal, can you honestly state that this is still the mission of the Small Business Administration? What is your current mission?

   b. What small business groups does your FY 1988 budget proposal help? How was the decision made as to which groups would be affected and by how much? [Note: In a previous meeting, an SBA official (Willie Gonzalez) stated that it was "subjective."]

Answer

   a. Yes. The proposed Agency budget request for FY 1988 provides for spending targets which adequately support all programs that have demonstrated their value, continuing need and are mandated by legislation. The budget provides full support to the Agency's most important role as the advocate for the small business at all levels of the government. Full support is also provided for the SBA's efforts to ensure equitable opportunity to small business ownership by the socially and economically disadvantaged Americans.

   As it was stated in our testimony, this budget proposal looks forward rather than backward. Thus, in light of constantly and rapidly changing market and economic conditions, the programs which emphasize the start-up, development and the growth of small businesses, rather than just helping them to stay in business, are being given the top priority.

   b. As the small business sector of our economy could be segregated in thousands of groups by nature of business; by ownership; by geographic location; by condition, or structure of their markets; etc., it is impossible to address impact on or the needs of every group. Therefore, this budget proposal was developed with the intent to optimize benefits/welfare of the small business sector in aggregate and not the welfare of any particular group within said sector.

   Of course, some groups, such as the businesses owned by socially and economically disadvantaged Americans, due to the proposed consolidation of MBDA programs within the SBA, could be considered relative "winners". Small defense oriented manufacturers and R&D firms can also be placed in the "winners" column due to the levels of support provided in the budget to "Breakout PCR" and the "Innovation, Research and Technology" programs.

Question

3. Looking at the redistribution of funding in the Investment Company Lending Program, I am interested in the reasoning behind the transfer of monies from the Direct (MESBIC) program to the Guaranteed (SBIC) program. When the MESBIC program was established, MESBICs were given preferred stock leverage in recognition of their more expensive) is being modified to add a one percent guaranty fee and to decrease the guarantee from 100% to 90%. Is it your expert opinion that the Minority Enterprise Small Business Investment Companies can survive, much less prosper, given this new funding structure? Was that considered during the budget development?

Answer

The Administration feels that it is time the MESBIC program be brought into the mainstream of the non-subsidized financial marketplace. It is proposed to achieve this in a gradual way by reducing the level of dependence on low-priced Federal funds, or in the case of preferred stock, no-cost Federal funds.

This Administration has no evidence that the existence of subsidized Federal dollars over the past 15 years insures the survival or prosperity of MESBICs. For example, 62 MESBICs representing 23% of all MESBICs ever licensed have been transferred to SBA's Office of Portfolio Management for liquidation. These 62 MESBICs had $76.1 million of Federal loans and preferred stock representing 21% of the total of all funds ever disbursed to MESBICs.

Furthermore, in many cases, the Federal subsidy implicit to the MESBIC program's funding structure has not served to the benefit of the small business borrower but to the benefit of the owners of the MESBICs who are not the intended beneficiaries of the program.

It is SBA's opinion that in the long run these changes to the MESBIC program will benefit the program. It is noted that the MESBIC trade association has embraced the COSBI concept of complete privatization.

Question

4. Has the Small Business Administration done an impact study or even made a rough analysis of the impact of the 1988 budget proposal?

Answer

A major study on the cost and economic effectiveness of SBA lending programs, which will also analyze the effects of the various 1988 budget proposals, is being conducted by the Office of Advocacy with the participation of the SBA's Office of Finance and Investment.

Informal qualitative analysis have been performed by individual program managers, indicating, in general, that while the budget proposal generates substantial reductions in program costs and outlays, the proposed budget levels have no significant negative impact on program deliveries.

Question

5. I would assume that prior to discussions with the Department of Commerce on the transfer of the Minority Business Development Administration to the SBAs Minority Small Business/Capital Ownership Development program, an assessment of the strength and weaknesses, successes and failures, and abilities to meet existing commitments was undertaken. What percent of the minority small businesses in this program go on to be self sustaining? Is there a profile of the small business that will go on to be self sustaining? Why do the others fail? [Note: No analysis has been done. The SBA has not tracked those that have "graduated" from this program. They do not know if the services that they are offering are of value or not.]

Answer

We have not conducted an in-depth analysis of the overall impact of the MSB&COD program on the program clients. However, we have actively participated in an opinion survey, conducted by the Senate Small Business Committee, of all clients completing their fixed program participation term, which we believe should answer some of these questions. Furthermore, we are looking into development of an ongoing SBA survey which should provide us on a regular basis these answers from both those 8(a) firms in the program and those who have completed the program.

The results of the SBA survey should alert us to areas which need adjustments as our clients proceed on their development strategies.

Senator LEVIN. We are now pleased to have Mr. Anthony Wilkinson, Senior Vice President, Stillwater National Bank, Stillwater, OK, representing Independent Bankers Association. Is that of Oklahoma, or of America? Tony, go ahead and commence.

STATEMENT OF ANTHONY R. WILKINSON, SENIOR VICE PRESIDENT, STILLWATER NATIONAL BANK AND TRUST CO., STILLWATER, OK

Mr. WILKINSON. My name is Anthony Wilkinson, I am Senior Vice President with the Stillwater National Bank and Trust Company, Stillwater, OK.

I am responsible for participation in the SBA lending programs; and a line lender, which means I deal directly with many small lending people. Our bank, with $190 million in assets is located in a community with approximately 40,000 residents.

I have been asked here today as a representative of the Independent Community Bankers who participate in the 7(a) Guarantee Lending Program. As one of the top volume SBA lenders in the country, we have experienced the many benefits of the SBA Guarantee Lending Program in our community. We are currently participants in the SBA Certified and Preferred Lender programs.

In the 1930s, 1940s and 1950s, the Department of Commerce, the Federal Reserve Board and others conducted independent studies of small business financing. They all concluded that a serious credit gap existed for small firms, because access to the capital markets was limited. And banks were, and continue to be reluctant to lend money on a long term basis.

Section 7(a) of the Small Business Act authorized SBA to guarantee loans made by private lenders to small businesses that can not otherwise obtain reasonable long term financing. The 7(a) Program offers terms and conditions that fit the needs of both the small business borrowers and the lenders.

The GAO also did an extensive survey in 1983, and concluded that the 7(a) Program was the Federal Government's answer to the small business need for long term financing. The survey's conclusion was that the Guarantee Loan Program had encouraged lenders to finance new ventures, and to make longer term loans. The data from the Senate Small Business Committee in March 1985, indicated that almost 70 percent of all loans made to small business with terms over 5 years, have SBA guarantees.

My comments today will focus on two of the Administration's budget proposals for SBA. One, to increase the guarantee fee on the 7(a) Loan Program from two to four points, and the other is to reduce the guarantee percentage from its current levels of 85 and 90 percent to 75 percent by the year 1992. Either of these could represent a devastating blow to the 7(a) Loan Program.

Given the importance of small businesses to our national and local economies, it is crucial that the SBA Guarantee Lending Program be maintained to provide small businesses with viable financing alternatives. Furthermore, it is important that the 7(a) Program be affordable to borrowers by keeping the fees as low as possible, and attractive to lenders by retaining as high a guarantee percentage for the loans.

The current budget proposal to raise the guarantee fees from 2 percent to 4 percent with the lenders paying one of the point fees, will price some borrowers out of the market. It is both unlikely and unrealistic to believe that the lenders will pay the one point fee. That fee will be passed on to the borrower, most likely in the form of a higher interest rate. Also, services such as loan document preparation, which many institutions like ours presently provide to borrowers for free, those services would no longer be free. We believe that two points is too high, and have proven in our bank that a one point fee can be more than enough.

These higher fees mean higher cost to the small business borrower, which ultimately serves as a deterrent to using the SBA programs. We believe that this four point guarantee proposal works directly against the people and businesses the SBA was specifically designed to assist. This fee increase proposal is similar to the current situation in Oklahoma. The local economic problems have forced local and state governments and big and small business alike to undergo massive structure reorganizations. Operations are being streamlined in an effort to cut costs, as the market will not allow for price increases.

What this tells us is that raising fees is not an automatic answser for covering burdensome overhead. Often markets simply will not bear an increase in cost. However, overhead can be reduced with some streamlining and internal cost cutting measures. Recently at our bank, we reduced our overhead by doing some tough, but necessary internal cost cutting.

We believe a study should be done internally at SBA to see what layers could be eliminated to make the SBA more efficient and cost-effective. The SBA program is still the only source of long term capital for small business. Let us not price it out of the market for the sake of covering burdensome overhead expenses.

In lieu of a fee increase, other steps could be taken to improve the quality of SBA loans.

The first step should be to place greater reliance on the private sector, by allowing the certified and preferred lenders to assume more responsibilities in return for additional benefits. These programs place the responsibility for the loan application analysis with the lending institutions, rather than SBA personnel. Lenders who have attained the CLP and PLP status, have earned this special status. However, SBA personnel are still reviewing these loans in detail, as if these lenders had no expertise.

For example, in the Oklahoma City area, there are six certified lenders, which generate approximately 70 percent of all SBA loan volume in the state. Over 90 percent of loan applications submitted by these lenders are accepted. But SBA retains three full time employees to review every loan submitted by these certified lenders in great detail. Does the SBA really need to conduct a detailed review of every loan submitted from proven lenders? I do not think so. This would seem to be to be a prime target for SBA to do a program modification, while not sacrificing on quality.

The second step to take would be to review the SBA loan underwriting standards in an effort to achieve an acceptable loan loss ratio. The point is, if you are taking unacceptable loan losses, tighten underwriting standards. This holds true for both the types of

loans being funded and for the lenders with whom SBA does business. There are SBA lenders which do not do effective or accurate credit analyses of the loans they recommend. SBA has thus far been reluctant to deal with some of these lenders who do not use the program effectively. Therefore, there are lenders who recommend our grant loans based primarily on the SBA guarantees, and do a limited or incomplete credit analysis.

If the lender does not use the loan program as it is intended, SBA should terminate its relationship with that lender. There are many lenders who are effectively serving the small business community, who must not be penalized due to these lenders. Good credit analysis must become a more integral part of the SBA loan process.

This would be a good area for SBA to utilize personnel and determine which lenders have the highest loss ratios. Steps could then be taken by SBA to improve their performance or to terminate their relationship.

Here is a research paper, which was prepared by SBA staff in 1985, which would be of interest to you. It covers a proposal to reward the PLP and the CLP lenders with a higher level of service, emphasizing the concept of treating your best partners in the best manner.

Stillwater National Bank did a study in early 1986 based on borrowers operating numbers up through the end of 1985. We will be updating these numbers again shortly, when our borrowers 1986 year end financial statements are received. But for now the year old numbers will have to do. At that time, we examined 160 loan files on which we had historical financial information. Those 160 loans used $27 million of SBA guarantee funds. The borrowers had paid $227,000 in guarantee fees, and the loan losses taken at that time had amounted to only $111,000. We did a sampling of 40 credits, and found that those 40 borrowers employed some 460 people. These 40 borrowers had used $6.6 million in SBA guarantee funds, and over a period, on the average of 25 months, generated $2.7 million in local, State, and national taxes since they had obtained their loans. This means that on the average, these borrowers were generating $108,000 per month in taxes. Obviously the SBA, the Government, and our community were all coming out ahead.

Our estimates for 1986 are that we will do 44 additional loans, for $8.5 million in gross dollars, using $6.8 million in SBA guarantee funds. These borrowers paid approximately $85,000 in guarantee fees, and some paid the higher 2 percent fee. Our additional loan losses in 1986 will amount to approximately $100,000. With our 1986 results, Stillwater National Bank has taken a total of six losses out of 215 loans in our 9 years in the program. These losses have totaled $211,000, while we took in guarantee fees of $312,000. These guarantee fees are based primarily on the 1 percent fee level. As I previously stated, I am convinced the 1 percent fee can more than adequately cover any loan losses, provided a sufficient credit analysis is done.

We must find lenders who will used the program correctly, establish appropriate underwriting guidelines, and cut unnecessary overhead out of the program, not just increase the guarantee fees.

Lowering the guarantee percentage will take some lenders out of the market. Banks are simply not organized to take the risks of funding long term loans, with short term deposits. The SBA guarantee is critical in enabling lending institutions to make long term loans to small business. With the present 90 percent guarantee, every $1 million of a banks capital enables the bank to make $10 million in loans. If the guarantee level is reduced to 80 percent, then for every $1 million in lender capital, only $5 million will be available to small businesses. With a 75 percent guarantee level, the amount available to small business falls to only $4 million. This points out rather dramatically, what even a small reduction in the guarantee level could do to the SBA program.

Reducing the guarantee percentage will make these loans significantly riskier, and much less attractive to lenders. Lenders will expect to be compensated for taking this additional term risk. This will result in higher cost to the borrowers, most likely in the form of higher interest rates.

To date, I have seen no data which supports the contention that a lower guarantee percentage will improve the credit quality of loans. It has been suggested that the SBA policy of increased liquidation responsibility for lenders, like what is presently used in the preferred lenders program, is a much greater incentive to making quality loans. SBA should be looking to place greater reliance on the lenders if they want to improve the program. A CLP or a PLP lender, by definition, must submit all the applications, notwithstanding the guarantee percentage. The SBA should continue to look for quality lenders who participate in a program, correctly eliminate those lenders who are abusing the program. We do not believe that reduction of the deficit is a very good reason for reducing the guarantee level. Last year, the Senate Small Business Committee reported that the net savings from reducing the guarantee percentage would be a mere $48 million over a 3 year period. It would seem that the loss in tax revenues from small business, who would not be able to get an affordable SBA loan would more than exceed this figure. Furthermore, continued improvement of loan quality should continue to reduce loan losses from the program.

The administration appears to oppose the SBA on the philosophic ground that Government should not be involved in free markets. We disagree. We believe this philosophy is too narrow, and fails to consider several important points. I would like to quote from a colleague of mine, who is also a former White House fellow, Tom Bennett, who testified before this Committee in 1985. "All students of economics know that in a market economy, many market failures exist. These include the competitive advantages of big business over small, with regards to economies of scales, access to capital markets, and the relative ability to set prices versus having to price products and services competitively. The SBA tends to correct some of these market failures by allowing small businesses the opportunity to access capital markets and obtain longer term capital."

The Administration's budget proposal for SBA is another attempt to make SBA a sacrificial lamb in the budget debate. The SBA is an excellent program that helps to get our Nation's entrepreneurs started, and helps keep them going. Certainly there is

room for improvement in many of SBA's activities, however it is a wise investment of public monies. Community bankers like myself are willing to work toward improving a program that both increases opportunities of thousands of American small business people and provides job opportunities for millions of Americans. The SBA 7(a) lending program is a programs that works, and let's keep it that way.

Mr. Chairman, I would like to thank you for calling this hearing on a very important small business issue. I want you to know that the Independent Bankers are looking forward to working with you and the Committee on these issues and pledge our active cooperation.

The CHAIRMAN. Thank you very much.

[The prepared statement of Mr. Wilkinson follows:]

S T A T E M E N T

of

ANTHONY R. WILKINSON

SENIOR VICE PRESIDENT

STILLWATER NATIONAL BANK AND TRUST COMPANY

STILLWATER, OKLAHOMA

BEFORE THE

COMMITTEE ON SMALL BUSINESS

UNITED STATES SENATE

FEBRUARY 24, 1987

Mr. Chairman, my name is Anthony R. Wilkinson. I am a Senior Vice President with the Stillwater National Bank in Stillwater, Oklahoma. Our bank, with $190,000,000 in assets, is located in a community with approximately 40,000 residents. Stillwater is the home of three major educational institutions, five large industries, and many small businesses.

I have been asked here today as a representative of the independent, community bankers who participate in the 7(a) guaranteed lending program. As one of the top volume SBA lenders in the country, we have experienced the many benefits of the SBA guaranteed lending program in our community. We are currently participants in the SBA Certified and Preferred Lender programs.

In the 1930's, 40's and 50's, the Department of Commerce, the Federal Reserve Board and others conducted independent studies of small business financing. They all concluded that a serious credit gap existed for small firms because access to the capital markets was limited and banks were and continue to be reluctant to lend money on a long-term basis. Section 7(a) of the Small Business Act authorized SBA to guarantee loans made by private lenders to small businesses that cannot otherwise obtain reasonable long-term financing. The 7(a) program offers terms and conditions that fit the needs of both the small business borrowers and the lenders.

The GAO also did an extensive survey of 9000 banks in 1983 and concluded that the 7(a) program was the Federal government's answer to the small business need for long-term financing. The GAO estimated that "approximately 40 percent of all loans to small businesses, both long-term and short-term, had an SBA guarantee. The survey's conclusion was that the guaranteed loan program has encouraged lenders to finance new ventures and to make longer term loans. Furthermore, data from the Senate Small Business Committee ("SBA: A Mission Accomplished," March, 1985) indicated that almost 70 percent of all loans to small businesses with terms over five years have SBA guarantees.

My comments today will focus on two of the Administration's budget proposals for SBA, one to increase the guaranty fee on the 7(a) loan program from two to four points, with three points paid by the borrower and one charged directly to the lender, and the other is to reduce the guaranteed percentage from 85 percent and 90 percent to 75 percent by 1992.

Given the importance of small businesses to our national and local economies, it is crucial that the SBA guaranteed lending program be maintained to provide small businesses with viable financing alternatives. Furthermore, it is important that the 7(a) program be affordable to borrowers by keeping the

fees as low as possible, and attractive to lenders by retaining a high guaranteed percentage for the loans.

The current budget proposal to raise the guaranty fees from 2 percent to 4 percent, with lenders paying one of the point fees, is very likely to price some borrowers out of the market. It is both unlikely and unrealistic to believe that the lenders will pay the one point fee. In some form or fashion, that one point lender fee will be passed onto the borrower, most likely in the form of a higher interest rate. It is also possible that services, such as loan document preparation, which many institutions like ours presently provide to borrowers for free would no longer be free. We believe that two points is too high and have proven in our bank that a one point fee can be more than enough. These higher fees mean higher costs to the small business borrower, which ultimately serves as a deterrent to using the SBA programs. We believe that this four point guaranty fee proposal works directly against the people and businesses the SBA was specifically designed to assist.

This fee increase proposal is similar to the current situation in Oklahoma. The local economic problems have forced the state government and big and small businesses alike to undergo massive structure reorganizations. The businesses are streamlining their operations because the market will not allow for price increases. What this tells you is that raising fees

is not always an automatic answer for cost and overhead problems. Often, markets will simply not bear an increase in costs. However, overhead can be reduced with some streamlining and internal cost cutting measures. Recently, at Stillwater National Bank we reduced our overhead by doing some tough but necessary internal cost cutting.

We believe a study should be done internally in SBA to see what bureaucratic layers could be eliminated to make the SBA more efficient and cost effective. The SBA program is still the only source of long-term capital for small business, so let's not price it out of the market for the sake of covering unnecessary SBA overhead expenses.

In lieu of a fee increase, several steps could be taken to improve the quality of the SBA loans. The first step should be to place greater reliance on the private sector by allowing the Certified and Preferred Lenders to assume more responsibilities in return for additional benefits. Presently, the Certified Lender and Preferred Lender programs place the responsibility for the loan application analyses with the lending institutions rather than SBA personnel. Lenders who have attained the CLP or PLP status have earned or should have earned this special status. However, SBA personnel are still reviewing these loans as if these lenders had no expertise. For example, in the Oklahoma City area, there are six certified lenders which generate over 70% of the SBA loan volume in that area. Over

90% of these loans are accepted, but SBA retains three full-time employees to review every loan submitted by these certified lenders. Does the SBA need to conduct a detailed review of every CLP/PLP loan? This would seem to be a prime target for SBA to do a program modification while not sacrificing loan quality.

The second step to take would be to review the SBA loan underwriting standards in an effort to achieve a "normal" loan loss ratio, such as that attributed to smaller dollar commercial loans. There are SBA lenders which do not do effective or accurate credit analyses of the loans they recommend. SBA has been reluctant to deal with these lenders who do not use the program effectively. Therefore, there are lenders who recommend or grant loans based primarily on the SBA guarantees and do a limited or incomplete credit analysis. If a lender does not play the game right, they must not be permitted to play. SBA should not be renewing the contracts for these lenders. There are many lenders who are effectively serving the small business community, who must not be penalized due to these lenders. Good credit analysis must become a more integral part of the SBA loan process. This would be a good area for SBA to utilize personnel and determine which lenders have the highest loss ratios. Steps could then be taken to eliminate these players.

There is a research paper which was prepared by SBA staff which should be of interest to you. It covers a proposal to reward the PLP/CLP lender with a higher level of service, emphasizing the concept of treating your best partners in the best manner.

At Stillwater National Bank, we did a study in early 1986 based on borrowers operating numbers up through the end of 1985. We will be updating these numbers again as more borrowers' 1986 year-end financial statements are received, but for now the year-old numbers will have to do. At that time, we examined 160 loan files on which we still had historical financial information. Those 160 loans used $27 million of SBA guaranty funds. The borrowers had paid $227,000 in guaranty fees and the loan losses taken at that time had amounted to only $111,000. We did a sampling of 40 credits and found that those 40 borrowers employed 460 people. These 40 borrowers had used $6.6 million in SBA guaranty funds and over a period of 25 months generated $2.7 million in local state and national taxes since they obtained their loans. On the average, these borrowers were generating $108,000 per month in taxes. Obviously, the SBA and the government were coming out way ahead.

Our estimates for 1986 are - 44 additional loans granted for $8.5 million gross, $6.8 million SBA guaranty part. These borrowers paid approximately $85,000 in guaranty fees, as some

paid the higher 2% fee. Our additional losses taken in 1986 will amount to approximately $100,000.

Stillwater National Bank has taken a total of six losses out of 215 loans in our nine years in the program. These losses have totalled $211,000 while we took in guaranty fees of $312,000. These guaranty fees are based primarily on the one percent fee level. As I previously stated, I am convinced the one percent fee can more than adequately cover any loan losses provided a sufficient credit analysis is done. We must find lenders who will use the program correctly, establish appropriate underwriting guidelines and cut unnecessary overhead out of the program not just increase the guaranty fees.

Lowering the guaranteed percentage will take some lenders out of the market. Banks are simply not organized to take the risks of funding long-term loans by taking short-term deposits. The SBA guaranty is critical in enabling lending institutions to make long-term loans to small business. With the present 90 percent guarantee, every one million of a bank's capital enables the bank to make $10 million in loans.

The National Association of Government Guaranteed Lenders has estimated that if the guaranty level is reduced to 80 percent, then for every one million in lender capital , only five million will be available to small business. With a 75 percent guaranty level, the amount available to small business

falls to only four million. This points out rather dramatically what even a small reduction in the guaranty level could do to the SBA program.

Reducing the guaranteed percentage will make these loans significantly riskier and much less attractive to lenders. Lenders will expect to be compensated for taking this additional risk. This will result in higher costs to the borrowers, most likely in the form of a higher interest rate.

There is no data available which supports the contention that a lower guaranteed percentage will improve the credit quality of these loans. It has been suggested that the SBA policy of increased liquidation responsibility for lenders, like what is presently used in the Preferred Lender Program, is a much greater incentive to making quality loans. As I stated earlier, SBA should be looking to place greater reliance on their lenders if they want to improve the program. A CLP or PLP lender by definition must submit quality applications notwithstanding the guaranty percentage. The SBA should continue to look for quality lenders who participate in the program correctly and eliminate those lenders who are abusing the program.

We do not believe that reduction of the deficit is a very good reason for reducing the guaranty. Last year, the Senate Small Business Committee reported that the net savings from

reducing the guaranteed percentage would be a mere $48 million over a three-year period. It would seem that the loss in tax revenues from small businesses, who would not be able to get an affordable SBA loan, would more than exceed this figure. Furthermore, continued improvement in loan quality should continue to reduce losses from the program.

The philosophy that government should not be involved in a "free market" apppears to be this Administration's line when it comes to SBA programs. Unfortunately, we believe this philosophy is too narrow and fails to consider several important points. I would like to quote from a colleague of mine who is also a former White House Fellow, Thomas Bennett:

> All students of economics know that in a market economy many market failures exist. These include the competitive advantages of big business over small with regards to economies of scale, access to capital markets and the relative ability to set prices versus having to price products and services competitively. The SBA tends to correct some of these market failures by allowing small businesses the opportunity to access capital markets and obtain longer term capital.

The Administration's budget proposal for SBA is another attempt to make SBA a sacrificial lamb in the budget debate. The Small Business Administration is an excellent government program that helps to get our nation's entrepreneurs started and helps keep them going. Certainly there is room for improvement in many of SBA's activities, however, it is a wise investment of public monies. Community bankers like myself, are willing to work towards improving a program that both increases the opportunities of thousands of American small business people and provides job opportunities for millions of Americans. The SBA 7(a) lending program is a program that works! Let's keep it that way.

Mr. Chairman, I would like to thank you for calling this hearing on a very important small business issue. I want you to know that the Independent Bankers are looking forward to working with you and the Committee on these issues and pledge our active cooperation.

The CHAIRMAN. Marc.

STATEMENT OF MARC TURTLETAUB, PRESIDENT, THE MONEY STORE INVESTMENT CORP., SACRAMENTO, CA

Mr. TURTLETAUB. Mr. Chairman and members of the Committee, it is my great pleasure to testify today regarding the President's fiscal year 1988 budget for the SBA. My pleasure comes, not only from the privilege of addressing this committee, but also because there is a fiscal 1988 budget for us to address. Without the efforts of this Committee over the last 2 years, we would not today have an independent agency dedicated to helping small business in America. In a sense this hearing is a vindication of your efforts.

I appear today in a two-fold capacity. First as president of the Money Store, a non-bank lender that has participated in the program for 8 years, and for the last 4 years has been the largest lender in the country, bank or non-bank. I also appear as a board member of the National Association of Government Guaranteed Lenders.

My company, the Money Store, has made a substantial commitment to SBA lending over the last 8 years. Last year alone, we issued $78 million worth of guaranteed loans. That is roughly twice the level of the second largest lender. This year, for the first quarter, we are operating at a level which will produce about 100 million dollars' worth of guaranteed loans. To date we have made loans in eleven states. Because we make more loans in more markets, and perhaps more significantly because we deal with more SBA offices than any other lender, we can give a unique marketplace perspective of the new budget.

Before addressing the specific budget proposals, I would very briefly like to recall what has occured in the last 2 years, in a sense, to set the stage for today's budget proposals.

Over the last 2 years, the budget of the SBA has been reduced by 70 percent. The guarantee fee has been increased by 100 percent, from one to two points. And, the maximum guarantee level on most loans has been reduced from 90 percent to 85 percent. Most importantly, over the last 2 years, there has been a raging policy debate regarding the SBA's future. As a result of these changes, the SBA has been weakened, the lending community has been weakened, and the small business community at large has been put at a disadvantage.

The SBA has been weakened by defections of long-term employees. In many cases, these employees were not replaced, or were replaced with trainees. In many cases, this has resulted in a great slow down of the processing of SBA loans. I recently met with an SBA Regional Administrator who commented to me: "My number one priority, no, change that, my only priority for 1987 is to improve the morale within the region." The lenders have similarly been affected. It has been impossible, as you can imagine, to hire quality personnel over the last 2 years while the future of the Agency was being debated in Washington. Further, slower processing at the SBA has had a chilling effect on borrowing. Most significantly, lowering of guarantee fees has had a tremendous affect on the most active SBA lenders.

We anticipate, as I mentioned, doing a $100 million of guaranteed loans this year. At a 90 percent guarantee level, we needed $10 million worth of capital. Under last year's change to an 85 percent level, we required $15 million worth of capital. We needed a 50 percent increase in capital, just to support the same level of business. Of course the net affect is that small businesses have been affected. The problems of the lenders and the problems of the SBA are visited upon the small business borrowers. In 1980, $2.9 billion worth of SBA loans were issued. In 1986, it was only 2.1 billion. Borrowers are less willing and less able to use the program. This then is the environment that exists today. The momentum that had been building to streamline the credit programs and to increase reliance on private lenders has been lost.

I would like to address very briefly two proposals for the Administration's budget today. Then I would like to put forth an alternative proposal, a proposal that we think will stimulate the Guaranteed Loan Program, yet simultaneously reduce costs within the SBA. The two issues I would like to raise are the two that Mr. Wilkinson raised. And that is: The imposition of additional fees from two points to four points, and the lowering of guarantee levels to a maximum of 75 percent.

The increase in fees comes in two ways, by increasing the fee to the borrower from two points to three points, and by imposing fee to the lender of one point. This issue, of course, was debated thoroughly last year. To reiterate the conclusion that this Committee came to, it is extremely rare in the marketplace to see three points charged on non-guaranteed loans. Although we have heard testimony today talking about a $21 a month or $21 a year increase on a $150,000 loan, I think perhaps a better illustration is to look at a $600,000 loan. A three point fee, which is assessed up front, and not over time, would amount to $18,000 to that small business borrower. This will price the product out of the mainstream of small business lending. The end result—we will get only the weakest borrowers. And that means higher default rates.

Further, charging the borrower three points will further depress demand. An SBA report, which was issued in June of 1986, and I understand was cleared by OMB last year, suggested a go slow attitude to adding on additional fees. I would like to read very briefly from that report. The report says: "There are many unknowns in adopting these policies. What will be the effect on program demand of higher credit standards and higher fees? We know what the direction will be—reduced demand. But we do not know the magnitude. Any program modifications should be flexible, to prohibit undue disruption and allow for necessary mid-course corrections. A proper phase-in would be vital to a successful test of the policy." And yet here we are, not a year later, with another Administration proposal to tack on additional fees.

I would suggest that we have not had an adequate time to assess the effects of last year's increased fees. Of course the budget assumes raising points to welverthe borrower will have an automatic increase in revenues. Unfortunately, the budget does not address the axiomatic issue that raising the price lowers the demand. If we have less loans, we have less revenues. Well, if the borrower can not pay the additional fee, how about the lender? This seems to be

the approach of the Agency. Perhaps the assumption is that lenders are getting rich from SBA loans. I suggest this is refuted by the simple facts.

One, overall loan volume has been dropping every year.

Two, many of the lenders who participated in the SBA loan program have dropped out. Over the last few years, we have seen Merrill Lynch drop out of the program, Beneficial Finance, Commercial Credit, and other major lenders.

Three, large banks have shown an increasing interest in small business lending, yet have not utilized the SBA program with vigor. In fact, they have backed away from the SBA program. So who are the top SBA lenders? Eight of the top ten, if we look at the list from last year, are either small banks like Mr. Wilkinson's, or non-banks, like my company. These lenders have been seriously hurt over the last 2 years. Why? Because there is a much smaller universe of potential borrowers, and because there is a much greater strain from lower guarantee fees.

Thus, tacking on an additional point to the small lender will ultimately force the small lenders to pass these costs on to their borrowers in the interest rate.

At best, and I say at best, because the Administration assumes that tacking on these fees will not diminish volume, which I think is a faulty assumption, but at best, it will raise $45 million worth of revenues. I would suggest this is not enough to justify the: (a), Higher costs to the borrower; (b), a decreased program usage; and (c), higher delinquencies which will inevitably follow.

The second issue I would like to address in the budget is the suggestion that we reduce the guarantee percentage to a maximum of 75 percent. To me, this is the most dangerous and least sensible of all the proposals in the budget.

The budget assumes that there will be no dollar savings from this lower guarantee, but that there will be less delinquency. While it is true that the lower guarantee loans perform better, it is not the guarantee rate which is the key to performance. Rather, the key to lower defaults and lower repurchase rates is the quality and the experience of the lender in the SBA program.

Presently, the lowest guarantee, 75 percent, goes to preferred lenders in the PLP program. Under PLP the SBA delegates credit, servicing, and liquidation to the lender. Only the best lenders get in. They are screened for their packaging quality, for their repurchase rates, for their volume, and for their delinquency. It is much like the American medical schools. Only the best students get in, very few fail out.

Thus, the lenders had low repurchase rates before they got into the PLP program. The 75 percent guarantee did not make them more competent or more cautious. To verify this theory, compare the default rates on generally processed loans and certified process loans. Here we see the same guarantee fee. CLP loans get the same guarantee as any lender coming into the program who is not a CLP lender. The only difference is that the CLP lender has had their repurchase rates and their delinquencies checked before they get in to the CLP program.

CLP lenders have a 4.2 percent dollar repurchase rate. Generally Processed Loans have a 9.2 percent dollar repurchase rate. This is

the key, and here is the message. If you want to find the key to lower losses, look to the best lenders, not to the lower guarantee rates. And herein lies the opportunity for this Committee—the opportunity to streamline the delivery system, pare costs, and lower delinquencies: Reward the best performers with higher guarantee rates, not lower. Although PLP is a very low cost program, it is not widely used. Of the $2.12 billion last year in guarantee loans, only $125 million were PLP processed. Of 135 PLP lenders, only 65 lenders use the PLP program. Why? The 75 percent rate is prohibitive. Particularly to the small banks and non-banks that are the leading lenders.

For us, to do $100 million worth of guarantee loans this year, at a 75 percent guarantee level, we would need $25 million worth of capital—75 percent across the board would drive the smaller lenders out of the program. This is clear. You would lose your best lenders. The end result is you would provide a disservice to small business. Instead, it makes more sense to incentivize the best performers to use PLP, thus, cutting costs and delinquencies.

PLP loans should be written with an 85 or a 90 percent guarantee, depending on whether the loan was over or under $155,000. If there must be a move to lower guarantees, which we do not support, it should be for the weaker lenders, not the strongest. In fact, this recommendation was made by the SBA itself, through their Office of Financial Institutions. That office monitors and licenses PLP and CLP lenders. They made the recommendation last year, which was distributed throughout the Agency, that the PLP lender be given a higher guarantee, not a lower guarantee.

In short, with this encouragement from the Agency, delinquencies would be lower, costs would be cut, and processing expedited. Everyone wins. The Government, the small business borrower, the lender, and the taxpayer.

I urge you to reject the Administration's budget proposals to increase user fees and to lower guarantees. The best path, to lower costs, and to serve the interest of small business is to do just the opposite. Thank you.

[The prepared statement of Mr. Turtletaub follows:]

STATEMENT OF

MARC TURTLETAUB

PRESIDENT

THE MONEY STORE INVESTMENT CORPORATION

BEFORE THE

COMMITTEE ON SMALL BUSINESS

UNITED STATES SENATE

FEBRUARY 24, 1987

2131 "L" STREET • SACRAMENTO, CALIFORNIA 95816 • (916) 446-1829

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

IT IS WITH GREAT PLEASURE THAT I TESTIFY TODAY CONCERNING THE PRESIDENT'S FISCAL 1988 BUDGET FOR THE SMALL BUSINESS ADMINISTRATION. THE PLEASURE COMES NOT ONLY FROM THE PRIVILEGE OF TESTIFYING BEFORE THIS COMMITTEE, BUT ALSO BECAUSE THERE IS AN SBA FISCAL 1988 BUDGET FOR US TO DISCUSS. IF MEMBERS OF THE COMMITTEE HAD NOT CHAMPIONED THE SURVIVAL OF THE SBA THE LAST TWO YEARS WE WOULD NOT TODAY HAVE AN INDEPENDENT AGENCY DEDICATED TO ASSISTING SMALL BUSINESS. IN A SENSE THIS HEARING IS A VINDICATION OF YOUR EFFORTS.

I APPEAR TODAY AS PRESIDENT OF THE MONEY STORE, A NON-BANK LENDER THAT HAS BEEN THE LARGEST SBA GUARANTEE LENDER IN THE COUNTRY - BANK OR NON-BANK - FOR THE PAST FOUR YEARS, AND AS A BOARD MEMBER OF THE NATIONAL ASSOCIATION OF GOVERNMENT GUARANTEED LENDERS (NAGGL). MY COMPANY HAS MADE A SUBSTANTIAL COMMITMENT TO THE GUARANTEE LOAN PROGRAM SINCE WE WERE FIRST ADMITTED TO PARTICIPATE IN 1979. LAST YEAR OUR 78 MILLION DOLLARS IN GUARANTEE LOANS WAS ROUGHLY TWICE THE LEVEL OF THE SECOND LARGEST LENDER. THROUGH THE FIRST QUARTER OF FISCAL YEAR 1987 WE ARE ORIGINATING LOANS AT A PACE IN EXCESS OF $100 MILLION. TO DATE WE HAVE ORIGINATED SBA LOANS IN ELEVEN DIFFERENT STATES. DUE TO THE SIZE OF OUR LOAN VOLUME AND THE DIVERSITY OF OUR ORIGINATION LOCATIONS, WE BELIEVE WE CAN OFFER A "MARKETPLACE PERSPECTIVE" ON THE 1988 BUDGET PROPOSAL IN A WAY

THAT NO OTHER LENDER OR SMALL BUSINESS BORROWER CAN PROVIDE. WE WORK WITH MORE BORROWERS IN MORE MARKETPLACES AND, PERHAPS MOST SIGNIFICANTLY, WITH MORE SBA DISTRICT OFFICES THAN ANY OTHER LENDER IN THE COUNTRY.

BEFORE ADDRESSING THE SPECIFIC 1988 PROPOSALS, I BELIEVE IT IS IMPORTANT TO TAKE A MOMENT TO BRIEFLY RECALL THE CHANGES THAT HAVE BEEN MADE IN THE SBA OVER THE LAST TWO YEARS, TO SET THE STAGE, IF YOU WILL, FOR THE PRESENT DISCUSSION. OVER THE LAST TWO YEARS THE BUDGET OF THE SBA HAS BEEN REDUCED BY 70%. THE GUARANTY FEE CHARGED ON SBA LOANS WAS INCREASED BY 100 PERCENT FROM ONE TO TWO POINTS PER LOAN, THE MAXIMUM GUARANTEE LEVEL WAS REDUCED ON MOST LOANS FROM 90 PERCENT TO 85 PERCENT. FURTHER, AS A RESULT OF THE POLICY DEBATE OVER THE AGENCY'S FUTURE, THE SBA HAS CLEARLY BEEN WEAKENED. MANY OF THE AGENCY'S LONG TERM EMPLOYEES HAVE DEFECTED IN FEAR OF THE DISMANTLING OF THE AGENCY AND IN MANY CASES NO REPLACEMENTS HAVE BEEN HIRED. IN OTHER INSTANCES NEW TRAINEES HAVE REPLACED "SEASONED" PERSONNEL. I HAD A RECENT CONVERSATION WITH AN SBA REGIONAL ADMINISTRATOR WHO SAID, "MY NUMBER ONE AND ONLY GOAL FOR 1987 IS TO REBUILD MORALE AND CONFIDENCE WITHIN THE AGENCY."

LENDERS HAVE ALSO BEEN ADVERSELY EFFECTED. IT HAS BEEN A MOST DIFFICULT TIME FOR LENDERS WHO SPECIALIZE IN SBA LENDING TO HIRE AND RETAIN QUALITY PERSONNEL WHILE THE FATE OF THE AGENCY WAS BEING DEBATED DAILY IN THE NEWSPAPERS. THE SBA'S INTERNAL

MORALE AND PERSONNEL PROBLEMS HAVE SLOWED PROCESSING IN SOME REGIONS TO A POINT WHERE IT HAS HAD A CHILLING EFFECT ON BORROWING. THE LOWERING OF GUARANTEES HAS PUT A SEVERE STRAIN ON THE CAPITAL REQUIREMENTS OF THE MOST ACTIVE SBA LENDERS, THE SMALL BANKS AND NON-BANKS. FOR EXAMPLE, FOR MY COMPANY TO DO $100 MILLION IN SBA LOANS IN 1987 - WITH A MAXIMUM 85 PERCENT GUARANTEE - WE WILL NEED $15 MILLION IN CAPITAL. AT THE PREVIOUS MAXIMUM LEVEL OF 90 PERCENT $10 MILLION OF CAPITAL WAS NECESSARY. THUS, IN ONE YEAR, OUR CAPITAL NEEDS INCREASED 50 PERCENT FOR THE SAME VOLUME OF BUSINESS.

THE PROBLEMS OF THE AGENCY AND THE LENDERS HAVE BECOME THE PROBLEMS OF THE SMALL BUSINESS COMMUNITY. SINCE 1980 THERE HAS BEEN A STEADY DECLINE IN SBA GUARANTEE LOAN ACTIVITY FROM $2.9 BILLION DOWN TO $2.1 BILLION. SMALL BUSINESSES ARE BECOMING LESS AND LESS WILLING AND/OR CAPABLE OF UTILIZING THIS PROGRAM.

THIS, THEN, IS THE CURRENT ENVIRONMENT. THE MOMENTUM THAT HAD BEEN BUILDING TO REORIENT THE SBA CREDIT PROGRAMS, TO MAKE THEM MORE EFFICIENT, TO INCREASE RELIANCE ON PRIVATE LENDERS, AND TO MAKE IMPORTANT ADJUSTMENTS TO MEET THE NEEDS OF THE MARKETPLACE HAS BEEN LOST.

I WOULD LIKE TO SPEND MY TIME THIS AFTERNOON NOT ONLY DISCUSSING THE ADMINISTRATION PROPOSALS, BUT ALSO REVIEWING AN ALTERNATIVE

IN THE HOPE THAT WE CAN PUT SOME NEW VITALITY INTO THE GUARANTEE LOAN PROGRAM. I RECOGNIZE THAT BUDGETARY CONSTRAINTS ARE STILL VERY REAL, AND THEREFORE, I WILL BE PROPOSING CHANGES THAT SHOULD ULTIMATELY REDUCE THE COSTS OF THE SBA LENDING PROGRAMS WITHOUT PRICING THE CREDIT ASSISTANCE IN SUCH A WAY AS TO MAKE IT USELESS TO THE CONSTITUENCY THE PROGRAM WAS DESIGNED TO HELP.

THREE ISSUES IN THE ADMINISTRATION'S BUDGET ARE PARTICULAR THREATS TO THE FUTURE OF THE SBA: 1) THE INCREASE IN GUARANTEE FEES; 2) THE ASSESSMENT OF A FEE ON SECONDARY MARKET PREMIUMS; AND 3) THE FURTHER REDUCTION OF THE GUARANTEE PERCENTAGE.

1) GUARANTEE FEES -

WERE INCREASED BY 100 PERCENT LAST YEAR FROM ONE TO TWO POINTS. THE PROPOSED LEGISLATION WOULD AGAIN DOUBLE THE FEE TO FOUR PERCENT. THE JUSTIFICATION FOR THIS CHANGE IS THAT IT WOULD BE FAR MORE EQUITABLE TO CHARGE A USER FEE TO THE PROGRAM BENEFICIARIES THAN TO THE PUBLIC AT LARGE. THE COROLLARY IS THAT USER FEES WOULD HELP REDUCE THE DEFICIT.

THE BUDGET PROPOSAL CALLS FOR ONE OF THE ADDITIONAL POINTS TO BE PAID BY THE BORROWER AND ONE PAID BY THE LENDER. THE MERITS AND DEMERITS OF CHARGING ADDITIONAL POINTS TO THE BORROWER WERE WELL-DEBATED BY THIS COMMITTEE AND THE CONGRESS LAST YEAR WHEN

IT WAS CONCLUDED THAT THE GUARANTEE FEE SHOULD BE INCREASED TO TWO POINTS. AS WAS POINTED OUT THEN, IT IS EXTREMELY RARE FOR LOAN FEES ON NON-GUARANTEED COMMERCIAL LOANS TO EXCEED TWO PERCENT. A THREE PERCENT FEE WILL PRICE THIS PRODUCT OUT OF THE MAINSTREAM OF SMALL BUSINESS LENDING, DISCOURAGING THE MORE FINANCIALLY SOUND BUSINESSES FROM SEEKING SBA GUARANTEED LOANS. ONLY THE LESS CREDITWORTHY BORROWERS WOULD BE WILLING TO PAY THREE POINTS FOR A COMMERCIAL LOAN THE RESULT COULD WELL BE AN INCREASE IN THE DEFAULT RATES ON THESE LOANS.

THE INCREASING OF FEES TO THE SMALL BUSINESS COULD ALSO WELL DIMINISH THE OVERALL DEMAND FOR SBA LOANS. THAT THIS FACT WAS UNDERSTOOD BY THE SBA AND THE ADMINISTRATION IS CERTAIN. IN JUNE 1986, THE SBA SUBMITTED A REPORT TO THE CONGRESS ENTITLED "ALTERNATIVE SOURCES FOR LOAN GUARANTEES". THIS REPORT WAS REQUIRED BY PUBLIC LAW 99-272 AND, I UNDERSTAND, WAS CLEARED BY THE OFFICE OF MANAGEMENT AND BUDGET PRIOR TO ITS TRANSMITTAL. THE REPORT ACKNOWLEDGES THAT INCREASED FEES WILL CERTAINLY CURTAIL BORROWING:

THERE ARE MANY UNKNOWNS IN ADOPTING (THESE)...POLICIES...WHAT WILL BE THE EFFECT ON PROGRAM DEMAND OF HIGHER CREDIT STANDARDS AND HIGHER FEES? WE KNOW WHAT THE DIRECTION WILL BE: REDUCED DEMAND. BUT, WE DON'T KNOW THE MAGNITUDE.

ANY PROGRAM MODIFICATIONS SHOULD BE FLEXIBLE TO PROHIBIT UNDUE DISRUPTION AND ALLOW FOR NECESSARY MID-COURSE CORRECTIONS.

A PROPER PHASE-IN WOULD BE VITAL TO A SUCCESSFUL TEST OF THE POLICY.

IT IS UNFORTUNATE THAT THIS COMMITTEE MUST CONSIDER ADDITIONAL FEES SO SOON AFTER RAISING THEM LAST YEAR, AND WITHOUT THE TIME NECESSARY TO ASSESS THE IMPACT OF THE PROGRAM CHANGES.

IF IN FACT THE THREE POINT FEE FURTHER DEPRESSES BORROWING IT COULD WELL BE THAT THE PROJECTED REVENUE FROM THESE FEES MIGHT NEVER BE REALIZED. THE ADMINISTRATION PROPOSAL ASSUMED RAISING COSTS WOULD STIMULATE REVENUE PROPORTIONATELY; IT OVERLOOKS THE AXIOMATIC DECREASE IN DEMAND THAT FOLLOWS PRICE INCREASES.

IF THE BORROWER CAN'T PAY IT, HOW ABOUT THE ADDITIONAL LENDER FEE OF ONE PERCENT? TO ANSWER THIS QUESTION IT IS HELPFUL TO LOOK AT THE MAKEUP OF THE SBA'S LEADING LENDERS. EIGHT OF THE TOP TEN NATIONAL LENDERS ARE EITHER SMALL BANKS OR NON-BANKS. THIS TREND CONTINUES THROUGHOUT THE LIST OF THE FIFTY LEADING LENDERS. AS DETAILED BEFORE, THESE SMALLER LENDERS HAVE BEEN SEVERELY IMPAIRED BY THE LOWERING OF THE GUARANTEE PERCENTAGE. THEY HAVE BEEN FURTHER IMPACTED BY THE INCREASE OF FEES TO THE BORROWER AND THE AGENCY PERSONNEL PROBLEMS.

THE UNIVERSE OF POTENTIAL BORROWERS HAS SHRUNK AND THE COST OF SERVICING THESE BORROWERS HAS ESCALATED. THE RESULT IS THAT SMALL BANK AND NON-BANK LENDERS ARE BEING DRIVEN AWAY FROM THE PROGRAM. IF THE ASSUMPTION OF THIS PROPOSAL IS THAT SBA LENDERS ARE GETTING RICHER MAKING THESE LOANS, I WOULD SUGGEST THAT THE

DECREASE IN OVERALL LOAN VOLUME REFUTES THIS AND THAT MERRILL LYNCH, BENEFICIAL FINANCE, COMMERCIAL CREDIT AND OTHER LENDERS WOULD HAVE REMAINED IN THE PROGRAM IF IT WERE SO. ALSO, THE LARGER BANKS, RECENTLY MORE INTERESTED IN SMALL BUSINESS LENDING, WOULD HAVE MORE FULLY UTILIZED THIS PROGRAM IF IT WERE LESS COSTLY TO PARTICIPATE. NO, IT IS THE SMALL, THINLY CAPITALIZED LENDERS WHO ARE WILLING TO SPECIALIZE IN SBA LOANS. TACKING ON AN ADDITIONAL FEE OF ONE PERCENT TO THESE LENDERS WILL ULTIMATELY FORCE THEM TO RAISE THEIR PRICE TO THE SMALL BUSINESS BORROWER.

CLEARLY THE INCREASE IN USER FEES DOES NOT JUSTIFY THE HIGHER BORROWING COSTS, DECREASED PROGRAM USAGE, AN INEVITABLE RISE IN DELINQUENCIES THAT WOULD FOLLOW. AT BEST - THAT IS, IF THE ADDITIONAL FEES DO NOT CAUSE A SEVERE DROP IN BORROWING - TWO MORE POINTS WILL ONLY RAISE $45 MILLION IN REVENUES. TOO GREAT A COST, I WOULD SUGGEST, FOR THE CONSEQUENCES.

2) <u>ASSESSING A FEE ON SECONDARY MARKET PREMIUMS</u> -

AGAIN THE ADMINISTRATION IS MAKING A FAULTY ASSUMPTION, IN THIS CASE, THAT THE RECEIPT OF A PREMIUM ON THE SECONDARY MARKET SALE IS DE FACTO AN "EXCESS PROFIT". HOW IT WAS DECIDED THAT ANY PREMIUM IS "EXCESSIVE" IS NOT CLEAR. CERTAINLY THERE WAS NO

EXAMINATION OF THE COSTS ASSOCIATED WITH MAKING SBA LOANS, NOR EVEN OF THE OTHER COMPONENT OF INCOME, THE AVERAGE INTEREST RATES CHARGED ON THESE LOANS.

CLEARLY THE PROPOSAL IS INSENSITIVE TO THE HIGH LENDER COSTS OF SBA LENDING. NON-SBA COMMERCIAL LOANS ARE TYPICALLY WRITTEN AT PRIME PLUS TWO TO PRIME PLUS THREE WITH ONE OR TWO POINTS GOING TO THE LENDER PLUS PREPAYMENT PENALTIES AND LATE FEES. SBA LOANS ALLOW NO POINTS TO THE LENDER, NO PENALITIES, AND NO LATE FEES. THE INTEREST RATE IS GENERALLY THE SAME.

FROM A COST STANDPOINT SBA LOANS ARE FAR MORE EXPENSIVE. FOR EXAMPLE, UNLIKE GENERAL COMMERCIAL LENDING, THE SBA DISCOURAGES CENTRALIZED LENDING AND SERVICING - EACH SBA DISTRICT PREFERS A LOCAL OFFICE WITH A LOCAL SERVICING ARM. FURTHER, SBA LENDING HAS A BUILT-IN ADDITIONAL EXPENSE: THE TIME IT TAKES FOR SBA CREDIT APPROVAL AND LEGAL REVIEW. PERSONNEL MUST BE TRAINED IN THE SPECIALIZED RULES AND REGULATIONS OF THE AGENCY. THIS IS A VERY PEOPLE INTENSIVE BUSINESS. AND THE RULES OF THE SBA LIMIT THE UNIVERSE OF POTENTIAL BORROWERS AS TO BUSINESS ACTIVITY, USE OF LOAN PROCEEDS, AND THE SIZE AND FINANCIAL STRENGTH OF THE BORROWERS. THERE ARE NO BANKS THAT TURN DOWN APPLICANTS FOR BEING TOO STRONG; THE SBA DOES.

ADDITIONALLY, SBA LOANS ARE INHERENTLY RISKIER THAN MOST OTHER COMMERCIAL CREDITS, AS THIS PROGRAM IS DESIGNED TO PROVIDE

FINANCING WHEN IT WOULD OTHERWISE BE UNAVAILABLE ON SIMILAR TERMS. THUS LOSSES MUST BE GREATER THAN TRADITIONAL ONE YEAR BANK LOANS. FINALLY, THERE ARE EVEN RESTRICTIONS ON HOW MUCH SBA LENDERS CAN BORROW TO SUPPORT THE UNGUARANTEED PORTION OF THEIR SBA PORTFOLIO. NONE OF THESE FACTORS HAVE BEEN CONSIDERED BY THE ADMINISTRATION IN SUGGESTING THAT THE LENDERS BE CHARGED A USER FEE AND THAT THEY BE ASSESSED A TWENTY PERCENT SURCHARGE ON THE SECONDARY MARKET PREMIUM.

THE OTHER WEAKNESS IN THE PROPOSAL IS THAT THE $15 MILLION PURPORTED SAVING IS ILLUSORY. FACED WITH THE PROSPECT OF LOSING SECONDARY MARKET INCOME, THE LENDERS WHO REMAINED IN THE PROGRAM WOULD SELL LOANS WITHOUT A PREMIUM, AT PAR AND WITH A LARGER SERVICING FEE. THUS THERE WOULD BE LESS UP FRONT FOR THE SMALL LENDERS WHO HAVE HAD THEIR CAPITAL ALREADY DEPLETED BY LOWER GUARANTEES - YET THE GOVERNMENT WOULD REALIZE NO ADDITIONAL REVENUE.

3) <u>REDUCTION OF THE GUARANTEE TO 75 PERCENT</u> -

THE ARGUMENT FOR FURTHER REDUCING THE MAXIMUM GUARANTEE LEVELS IS PERHAPS THE MOST DANGEROUS AND LEAST SENSIBLE OF ALL THREE PROPOSALS. WHILE IT HAS BEEN ESTIMATED IN THE BUDGET TO HAVE NO ACTUAL DOLLAR SAVINGS, THE PROPOSAL IS BASED ON THE ASSUMPTION THAT LOAN QUALITY WILL IMPROVE BY PUTTING THE LENDER MORE AT RISK.

CERTAINLY LOANS WITH SMALLER GUARANTEES HAVE PERFORMED BETTER. BUT IT IS FALLACIOUS TO ASSUME THAT THE LOWER GUARANTEE IS THE REASON FOR THE LOWER REPURCHASE RATES. PRESENTLY THE LOWEST MAXIMUM GUARANTEES ARE OFFERED ON PREFERRED LENDER PROGRAM (PLP) LOANS: 75 PERCENT. THE PLP DESIGNATION - UNDER WHICH THE AGENCY DELEGATES CREDIT, SERVICING, AND LIQUIDATION FUNCTIONS TO THE LENDER - IS AVAILABLE ONLY TO THE MOST EXPERIENCED AND BEST SBA GUARANTEE LENDERS. TO BECOME A PLP PARTICIPANT, PRODUCTION LEVELS, LOAN PRESENTATIONS, REPURCHASE RATES, AND DELINQUENCIES MUST MEET EXACTING STANDARDS. IT IS MUCH LIKE AMERICAN MEDICAL SCHOOLS - ONLY THE BRIGHTEST STUDENTS GET IN AND VERY FEW FAIL ONCE ADMITTED. BECAUSE ONLY THE BEST SBA LENDERS GET INTO THE PLP PROGRAM TO BEGIN WITH, THEIR LOANS PERFORM BEST. THESE LENDERS WERE PERFORMERS EVEN BEFORE ENTERING THE PROGRAM; THE 75 PERCENT GUARANTEE HAS NOT MADE THEM MORE COMPETENT OR CAUTIOUS.

TO TEST THIS WE NEED ONLY LOOK AT THE REPURCHASE RATES OF THE CERTIFIED LENDER PROGRAM (CLP) VERSUS NON-CLP LOANS. WITH CLP PROCESSING OR WITHOUT IT THE GUARANTEE LEVELS ARE IDENTICAL, 90 PERCENT ON LOANS UNDER $155,000 AND 85 PERCENT ON LOANS OVER $155,000. YET THE CLP PROCESSED LOANS HAVE A DOLLAR REPURCHASED RATE OF 4.2 PERCENT COMPARED TO THE GENERALLY PROCESSED LOAN REPURCHASE RATE OF 9.2 PERCENT. THE ONLY DIFFERENCE IS THAT THE CLP LENDERS ARE SCREENED BEFORE ADMITTING THEM TO THIS PRIORITY PROCESSING PROGRAM. ONLY THE BEST PERFORMERS ARE ADMITTED.

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THE MESSAGE IS THAT THE GUARANTEE PERCENTAGE IS NOT THE KEY TO LOWER REPURCHASE RATES, RATHER IT IS THE EXPERIENCE AND QUALITY OF THE LENDER WHICH DETERMINES REPURCHASE RATES. THE FASTEST AND MOST EFFICIENT PROGRAM OFFERS THE LOWEST GUARANTEE. IRONICALLY, THE BEST PERFORMERS GET THE WORST GUARANTEE LEVEL.

HEREIN LIES THE GREATEST OPPORTUNITY FOR THE AGENCY TO STREAMLINE ITS DELIVERY SYSTEM, PARE COSTS, AND LOWER DELIQUENCY: REWARD THE PERFORMERS WITH HIGHER GUARANTEES LEVELS NOT LOWER. ALTHOUGH THE PLP IS THE SBA'S LOW-COST DELIVERY PROGRAM, IT IS NOT WIDELY USED BECAUSE OF THE 75 PERCENT GUARANTEE LEVEL. OF THE $2.12 BILLION IN GUARANTEE APPROVALS IN FISCAL YEAR 1986, ONLY $125 MILLION WERE PLP PROCESSED. OF THE 135 LENDERS IN THE PLP PROGRAM, ONLY 65 USED THE SYSTEM LAST YEAR.

AGAIN, WE MUST UNDERSCORE THAT THE MOST ACTIVE LENDER PARTICIPANTS ARE SMALL BANKS AND NON-BANKS. TO ASK THEM TO PROCESS LOANS AT 75 PERCENT WOULD BE IMPOSSIBLE. MOST WOULD LEAVE THE PROGRAM. FOR MY COMPANY TO DO $100 MILLION THIS YEAR AT A 75 PERCENT GUARANTEE I WOULD NEED $25 MILLION IN CAPITAL INSTEAD OF THE $10 MILLION NEEDED AT THE 90 PERCENT LEVEL.

IT MAKES FAR MORE SENSE TO INCENTIVIZE THE SMALLER LENDERS WHO PERFORM WELL TO USE THE PLP PROGRAM, THUS CUTTING SBA COSTS AND

REWARDING THE PERFORMERS WITH A STREAMLINED DELIVERY SYSTEM. IF THE LENDER'S PERFORMANCE LAGS, THE PARTICIPANT CAN SUBSEQUENTLY BE REMOVED FROM THE PROGRAM.

PLP LOANS SHOULD BE WRITTEN WITH EITHER AN 85 OR 90% GUARANTEE, DEPENDING ON WHETHER THE LOAN IS UNDER OR OVER $155,000. IF THERE IS TO BE A MOVE TO REDUCE GUARANTEE LEVELS AT ALL, IT SHOULD BE FOR THE WEAKEST LENDERS NOT THE STRONGEST.

IN FACT A RECOMMENDATION TO RAISE PLP GUARANTEE LEVELS HAS ALREADY BEEN MADE BY THE OFFICE BY FINANCIAL INSTITUTIONS, THE SBA'S ARM WHICH MONITORS AND LICENSES CERTIFIED, PREFERRED, AND NON-BANK LENDERS. IN SHORT, THE SBA SHOULD BE ATTACHING THE MAXIMUM GUARANTEE TO ITS LEAST RISKY LOANS (PLP LOANS HAVE A 1.3 PERCENT REPURCHASE RATE) RATHER THAN THE MOST RISKY LOANS. WITH THIS ENCOURAGEMENT FROM THE AGENCY, DELINQUENCIES WOULD BE LOWER, COSTS CUTS, AND PROCESSING EXPEDITED. EVERYONE WINS - THE GOVERNMENT, THE SMALL BUSINESS BORROWER, THE LENDER AND THE TAXPAYER.

I URGE YOU TO REJECT THE ADMINISTRATION'S BUDGET PROPOSALS TO TACK ON USER FEES AND TO LOWER GUARANTEES. THE BEST PATH TO LOWER COSTS AND SERVE THE INTEREST OF SMALL BUSINESS IS TO DO JUST THE OPPOSITE. THANK YOU.

Top 50 Lenders' Ranking-Loan Approvl Basis
FY 1987(1st qtr)

n*	1	The Money Store Investment C.	USA	103	27,106,800
*	2	Marine Midland Bank	NY	53	9,289,800
n*	3	Southwestern Commercial Cap.	TX	50	14,060,800
n*	4	Allied Lending Corp.	USA	45	5,368,300
*	5	Truckee River Bank	CA	40	10,347,790
n*	6	Government Funding CALBIDCO	CA	36	5,651,800
*	7	Bank of America	CA	31	6,194,300
*	8	The Merchants Bank	VT	30	7,477,600
n	9	Mercury S&L Asso	CA	27	7,862,500
	10	Mechanics National Bank	CA	25	5,976,000
*	11	Banco Popular du PR	PR	23	3,190,800
*	12	Heritage Bank	GA	20	5,239,000
n*	13	Independence Mortgage Inc.	TX	18	6,794,300
*	14	Citibank, NA	NY	17	4,889,000
*	15	Liberty National Bank	CA	16	4,713,500
n*	16	Abode S&L Asso	CA	16	2,296,000
*	17	American Pacific State Bank	CA	14	2,733,000
*	18	First Security Bank-Idaho, NA	ID	14	2,636,000
*	19	Norstar Bank	NY	14	1,561,250
*	20	Meridian Bank	PA	13	3,404,530
*	21	Vermont National Bank	VT	13	2,922,425
n*	22	Gulf American SBL, Inc	FL	12	5,590,000
*	23	National Westminster Bank	NY	12	2,476,000
*	24	First Bank-San Luis Obispo	CA	12	2,405,000
*	25	Bank of Commerce	CA	12	1,819,000
*	26	Chase Lincoln Firt Bank,NA	NY	12	1,663,300
n*	27	Southern Fed S&L Asso.	GA	11	3,166,400
*	28	First City National Bank	MO	11	2,111,650
*	29	Key Bank-Western NY	NY	11	2,035,000
*	30	The Randolph National Bank	VT	11	1,733,500
*	31	Commerce Union Bank	TN	10	3,425,100
*	32	Old National Bank-WA	WA	10	2,390,500
	33	First Pacific Bank	CA	10	2,168,300
*	34	Security Bank	OK	10	2,054,900
*	35	Valley Bank of Helena	MT	10	2,023,000
*	36	Brighton Bank	UT	10	1,939,000
*	37	Pittsburgh Nat Bank	PA	10	1,750,400
*	38	First Amer Nat Bank/Nashville	TN	10	1,456,500
	39	Bank of Fresno	CA	10	1,437,700
*	40	Union Bank	MO	10	1,074,000
*	41	Rainier National Bank	WA	10	666,900
*	42	Third National Bank-Nashville	TN	9	2,424,458
*	43	Valley National Bank	IA	9	2,271,500
n*	44	The Business Development Corp	GA	9	1,955,100
*	45	Stillwater National Bank	OK	9	1,846,000
*	46	Bank of New England-West	MA	9	1,617,000
*	47	Casco Northern Bank,NA	ME	9	1,587,000
*	48	Chittenden Trust Co.	VT	9	1,528,000
*	49	City Bank	WA	9	1,509,000
*	50	United Missouri Bank-Kansas C.	MO	9	1,431,000
*		Key Bank-Central NY	NY	9	1,411,300
*		Bank of Hawaii	HI	9	1,199,200
*		Metcalf State Bank	KS	9	723,600

* CLP Lender
n Non-Bank Lender

OBSERVATION: The 53 lenders, above, account for 940 loan approvals, valued at approximately $202MM, during the First Quarter.

Overall 7(a) City activity during the First Quarter; 3,606 loans approved.

Therefore, these few (53) lenders represented approx. 26% of the total loan volume.

Of these 53 lenders, 50 are CLP lenders, and 10 of the 53 are either Small Business Lending Companies or other Non-Banking financial institutions.

The CHAIRMAN. Thank you. Gentlemen, if it is possible, because of the time constraints, if you could summarize at any point in your testimony, the Chair would certainly appreciate it. I do not want to cut you off, I know you have worked hard on your testimony, and it is all excellent testimony, I might say. But if you can at any point in your testimony summarize, the Chair would be most grateful.

Mr. Wilkins.

STATEMENT OF HERBERT P. WILKINS, PRESIDENT, SYNCOM CAPITAL CORP., WASHINGTON, DC, REPRESENTING THE NATIONAL ASSOCIATION OF INVESTMENT COMPANIES

Mr. WILKINS. Thank you, Mr. Chairman. I will take the opportunity and leave my testimony for the record, and go off on another unprepared approach to my presentation this afternoon.

I noted earlier this afternoon in the comments of Mr. Holloway, that he somehow made an assumption in presenting the position of the SBA that the reason why they thought they could afford to increase the fees, or the cost of money to the small business, was an assumption that somehow, because of a lower rate today, interest rate today, small business had available to it some, and he used the number 12½ percent. I guess he assumed that was a number that small business had to play with, that 12½ percent interest differential, which represents the cost of money, the difference between the cost of money today and the cost of money in 1981.

It appears to me, in having gone through the Administration's proposal, that somehow the Administration, in determining how it should structure its budget, said that it was quite obvious to them that small business people were raking in a fortune out there because of this interest differential, and the Administration ought to go out there and somehow cover its deficit by charging a much higher amount for fees for services that the Administration proposed to provide to the SBA.

I have some real concerns with that logic, and the approach that appears in the Administration's budget proposal. That may not have been their original intent when they started, but that is what they have accomplished. And that is to assume that small business people have excess money that they can use to pay higher costs and fees for capital that they obtain from the SBA.

The MESBIC industry, many of you are very familiar with what we have done over the years, has been able to survive in the tough, hard years, because of the availability to that industry of low cost preferred stock. In fact, this year, SYNCOM, my company, has been quite profitable. But if I go back to 1979, when we first got started in the venture capital business, financing minority small business, I can tell you we really suffered. We suffered to the point where, to reach profitability, we lost cumulatively some $1 million in financing minority small businesses.

That means, that to develop by venture capital portfolio of roughly 26 companies, we lost $1 million of capital of that $2.25 million that we had invested in the company, that we were carrying in negative retained earnings. Preferred stock, that we were able to leverage through the SBA allowed us to stay in business. It allowed

us to allow our portfolio to mature and then to achieve profitability.

Today, fortunately for SYNCOM, we are in the position of being extremely profitable. That is not true for a number of other MESBICs, which have only just gotten off the ground. It is preferred stock which will allow them to develop their portfolios, and it is our opinion, and speaking for the industry, the MESBIC industry, that without preferred stock, we can not continue to invest in minority small businesses.

It is interesting, when the Administration first came out with its proposal, I went over to the SBA and asked them what the rationale was for the proposed cuts. They said that they felt that the industry, over the years, had somehow shown that it would make a go of it, even with higher costs to capital. It was their belief, that the MESBIC industry had done fairly well, in that with the existing capital base that we had in place, we should be able to average the higher cost of new leverage that is debt through debentures, over our existing capital base.

I asked them if they had considered what would happen to new entrants into the industry. They had not really, they had no response for that.

I also asked the Administration whether or not, in their proposed changes in the way MESBIC's are funded, they had considered at all the commitment that the legislation, which developed 301(d) investment companies had in fact produced, on the part of the Government to support minority small businesses. I do not think that they had really thought that through.

In fact, if you look clearly at what MESBIC's do, we obligate ourselves, when we license to finance the most risky entrepreneurs in the economy. These are minority persons who are typically rejected by every single other potential funding source. We agree to use our private capital, and MESBIC's are privately financed. That is we use our private capital that is matched by the government, to finance these businesses. We risk our capital. We believe that we can do the job, and that is select few companies believe they have the managerial talent to go the long road, the 10 years that it takes to develop that portfolio to make money. We risk our capital to do that.

Over the years, SBA, we thought was also risking something. Or at least paying something for that, I guess, benefit to the general community. And that is the creation of minority small business. We thought the price to SBA was very small indeed. SBA put up three percent preferred stock and some subsidy money, and the MESBIC industry along with the SBIC industry paid SBA's operating costs for the administration of the program. That was done back in 1982 in a prior budget proposal, when fees were instituted which allowed SBA to recover all of its operating costs.

Now SBA proposes to increase fees and also to increase the cost of money. Not only to just cover its cost, but to make the SBIC program a profit center. That is what they propose to do. Thinking all along that the minority business community that we service has extra money in its pockets which it can merely just pay over to the SBIC so the SBIC's in turn can pay the SBA.

I think that the logic that the SBA is using leaves a lot to be desired. And Mr. Chairman, I am really concerned that after all the years of testimony and all the crazy proposals that have come out of the SBA in the last 6 years or so, that this one really is a whopper.

We object to it, and we are very concerned that, to be allowed to go forward, it would mean the demise of a program that has had tremendous benefit to our economy. Thank you.

The CHAIRMAN. Thank you, Mr. Wilkins. That was excellent testimony.

[The prepared statement of Mr. Wilkins follows:]

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TESTIMONY

BY

HERBERT P. WILKINS
CHAIRMAN

NATIONAL ASSOCIATION OF
INVESTMENT COMPANIES

BEFORE THE

SENATE SMALL BUSINESS COMMITTEE

FEBRUARY 24, 1987

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New York, New York

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Ibero American Investors Corp.
Rochester, New York

GOOD AFTERNOON MR. CHAIRMAN AND MEMBERS OF THE SENATE SMALL BUSINESS COMMITTEE. I AM HERBERT P. WILKINS, PRESIDENT OF SYNCOM CAPITAL CORPORATION IN WASHINGTON, D.C. I ALSO SERVE AS CHAIRMAN OF THE NATIONAL ASSOCIATION OF INVESTMENT COMPANIES (NAIC), FORMERLY KNOWN AS THE AMERICAN ASSOCIATION OF MINORITY ENTERPRISE SMALL BUSINESS INVESTMENT COMPANIES (AAMESBIC).

SYNCOM IS A SUBSIDIARY OF SYNDICATED COMMUNICATIONS, WHICH WAS ESTABLISHED WITH MONEY FROM THE FORD FOUNDATION, THE COOPERATIVE ASSISTANCE FUND, AND THE PRESBYTERIAN ECONOMIC DEVELOPMENT CORPORATION. JACK GLOSTER, FORMER PRESIDENT OF OPPORTUNITY FUNDING CORPORATION, REALIZED IN THE MID 1970'S THAT A LARGE NUMBER OF COMMUNICATIONS PROPERTIES WERE POTENTIAL MINORITY INVESTMENTS. AT THE TIME THE GOVERNMENT WOULD NOT LOAN MONEY FOR COMMUNICATIONS INVESTMENTS BECAUSE OF PERCEIVED FIRST AMENDMENT CONFLICTS, SO SYNCOM WAS CONCEIVED TO FILL THE GAP WITH PRIVATE, FOR-PROFIT VENTURE CAPITAL. SYNCOM'S PURPOSE WAS TO SHOW THAT IT WAS POSSIBLE AND PROFITABLE TO INVEST IN MINORITY-OWNED COMMUNICATIONS COMPANIES.

NINE YEARS LATER, SYNCOM, IS PROVING ITS POINT. SYNCOM AND OTHER MESBICS HAVE HELPED TO FINANCE APPROXIMATELY 75% OF THE EXISTING MINORITY TELECOMMUNICATIONS BUSINESSES. WE ARE ESTABLISHING A PRESENCE FOR MINORITIES IN THE COMMUNICATIONS FIELD, AND PROVING THAT IT CAN BE PROFITABLE TO DO SO. LAST YEAR, SYNCOM'S PRETAX INCOME WAS $3.6 MILLION. THIS DEMONSTRATES NOT ONLY THE SUCCESS OF SYNCOM, BUT THE SUCCESS OF THE MINORITY OWNED BUSINESSES IN WHICH WE HAVE INVESTED.

AS CHAIRMAN OF THE NATIONAL ASSOCIATION OF INVESTMENT COMPANIES, I AM HERE TODAY REPRESENTING AN INDUSTRY OF APPROXIMATELY 150 INVESTMENT COMPANIES. LAST YEAR, OUR COMPANIES INVESTED $145 MILLION IN 1,440 MINORITY OWNED SMALL BUSINESSES. IN ADDITION TO SUPPORTING MINORITY ENTREPRENEURSHIP, THOSE INVESTMENTS HELPED TO CREATE OR MAINTAIN AN ESTIMATED 18,720 JOBS AND GENERATE ESTIMATED GOVERNMENT TAX COLLECTIONS OF ALMOST $140 MILLION. ALTHOUGH THESE NUMBERS BY THEMSELVES ARE IMPRESSIVE, THEY BECOME EVEN MORE SO WHEN THE "MULTIPLIER EFFECT" OF OUR INVESTMENTS IS CONSIDERED. USING LAST YEAR AS AN EXAMPLE, THE SBA PROVIDED $39 MILLION IN LEVERAGE TO MESBICs. MESBICs, IN TURN, INVESTED $145 MILLION IN MINORITY OWNED SMALL BUSINESSES. THIS $145 MILLION IN MESBIC MONEY IS ESTIMATED TO HAVE ATTRACTED AN ADDITIONAL $290 MILLION INTO MINORITY BUSINESSES FROM OTHER PRIVATE SECTOR SOURCES. THESE SOURCES WERE ONLY WILLING TO PROVIDE THE CAPITAL, HOWEVER, AFTER MESBICs HAD TAKEN THE POSITION OF FIRST RISK. THE TOTAL INVESTMENT IN THE MINORITY SMALL BUSINESS COMMUNITY AS A RESULT OF THE GOVERNMENT'S $39 MILLION LEVERAGE TO MESBICs LAST YEAR WAS THUS $435 MILLION, PROVIDING AN IMPRESSIVE COST-BENEFIT RATIO OF 1 TO 11. IN SIMPLER TERMS, FOR EVERY DOLLAR THE GOVERNMENT INVESTS IN THE MESBIC INDUSTRY, ELEVEN DOLLARS IS INVESTED IN THE MINORITY SMALL BUSINESS COMMUNITY.

WHEN THE MESBIC PROGRAM WAS ESTABLISHED, THE LEVERAGE SYSTEM WAS SET UP SO THE SMALL BUSINESS ADMINISTRATION COULD OFFER MATCHING FUNDS TO MESBICs IN TWO VERY DISTINCT FORMS. EACH OF

THE FORMS WAS DESIGNED WITH A PARTICULAR PURPOSE IN MIND. THE FIRST FORM ALLOWS THE SBA TO PURCHASE 3% CUMMULATIVE PREFERRED STOCK IN A MESBIC. PREFERRED STOCK LEVERAGE IS USUALLY THE FIRST TYPE OF LEVERAGE OBTAINED BY A MESBIC, BECAUSE IT FREES THE INVESTMENT COMPANY FROM HEAVY DEBT SERVICE OBLIGATIONS AS IT IS SETTING UP ITS PORTFOLIO AND WAITING FOR THE INVESTMENTS TO BEGIN TO GENERATE A CASH FLOW. THE AVAILABILITY OF PREFERRED STOCK LEVERAGE IS PARTICULARLY IMPORTANT BECAUSE IT ALLOWS MESBICs TO MAKE EQUITY INVESTMENTS IN MINORITY SMALL BUSINESSES THAT THEY COULD NOT MAKE IF THEY WERE CONCERNED WITH COVERING THEIR DEBT SERVICE. THE SECOND TYPE OF MESBIC LEVERAGE IS SUBSIDIZED DEBENTURES. THE SBA PURCHASES TEN YEAR DEBENTURES FROM MESBICs. THESE DEBENTURES CARRY AN INTEREST RATE EQUAL TO THE FEDERAL FINANCING BANK RATE, WITH A 3% INTEREST RATE SUBSIDY FOR THE FIRST FIVE YEARS OF THE DEBENTURE. DEBENTURES ARE TYPICALLY TAKEN DOWN BY MESBICs THAT ALREADY HAVE AT LEAST ONE TIER OF PREFERRED AND HAVE BEGUN TO GENERATE A CASH FLOW THAT CAN BE USED TO COVER DEBT SERVICING. THE SECOND TIER OF PREFERRED STOCK LEVERAGE IS AVAILABLE ONLY TO THOSE COMPANIES THAT HAVE PROVEN RECORDS OF PROVIDING EQUITY CAPITAL, UNSECURED SUBORDINATE DEBT, OR SIMILAR FORMS OF FUNDING THAT TYPICALLY CARRY WITH THEM A HIGHER LEVEL OF RISK, BUT ARE LESS BURDENSOME ON THE MINORITY ENTREPRENEURS.

ALTHOUGH FORMS OF MESBIC LEVERAGE HAVE REMAINED THE SAME, MANY OTHER THINGS HAVE CHANGED THROUGHOUT THE YEARS. WHEN THE PROGRAM WAS FIRST ESTABLISHED, THE MINIMUM PRIVATE CAPITAL REQUIREMENT FOR STARTING A MESBIC WAS $250,000. THAT FIGURE HAS

NOW RISEN TO ONE MILLION DOLLARS IN RECOGNITION OF THE NEED FOR A SUBSTANTIAL CAPITAL BASE TO SUCCESSFULLY COVER THE COSTS OF RUNNING AN INVESTMENT COMPANY. FOR MANY YEARS, MESBICs AUTOMATICALLY RECEIVED THEIR FIRST TIER OF PREFERRED STOCK LEVERAGE. THEY NOW MUST INVEST AT LEAST 65% OF THEIR PRIVATE CAPITAL BEFORE THEY BECOME ELIGIBLE. QUALIFICATIONS FOR MESBIC INVESTMENT ADVISORS HAVE BECOME MUCH STRICTER AND HAVE RESULTED IN MUCH MORE SOPHISTICATED INVESTORS AND INVESTMENTS. ALL OF THESE CHANGES HAVE HELPED TO IMPROVE THE INDUSTRY OVER THE YEARS. IN A SENSE, THEY HAVE BEEN GRADUAL MOVES TOWARD MAKING THE INDUSTRY MORE SUCCESSFUL AND SELF-SUSTAINING. WE HAVE WELCOMED THESE IMPROVEMENTS, AND I CAN ASSURE YOU THAT NO ONE WANTS THE PROGRAM TO BE MORE SUCCESSFUL AND EVENTUALLY SELF-SUSTAINING THAN WE DO.

THE ADMINISTRATION HAS OFFERED A BUDGET PROPOSAL THIS YEAR THAT SUPPOSEDLY WILL HELP MESBICs TO ACHIEVE THESE GOALS. IN REALITY, HOWEVER, THE PROPOSAL WOULD LEAD TO THE INDUSTRY'S DEMISE. THE ADMINISTRATION PROPOSES TO DECREASE DIRECT FUNDING FOR MESBICs FROM ITS FISCAL YEAR 1987 LEVEL OF $39 MILLION TO JUST $20 MILLION. THE $19 MILLION DECREASE REPRESENTS THEIR PLAN TO ELIMINATE PREFERRED STOCK LEVERAGE TO MESBICs. IN PLACE OF THE PREFERRED STOCK LEVERAGE, THEY PROPOSE TO MAKE AVAILABLE $14 MILLION IN GUARANTEED FUNDING TO ALLOW MESBICs TO OBTAIN FUNDS THROUGH THE SBIC FUNDING CORP. THIS PROPOSAL WILL NOT WORK FOR SEVERAL REASONS.

FIRST, THE AVAILABILITY OF PREFERRED STOCK LEVERAGE IS ABSOLUTELY ESSENTIAL TO THE MESBIC INDUSTRY. OUR PROGRAM WAS SET

UP TO MAKE LONG TERM, PATIENT EQUITY CAPITAL AVAILABLE TO THE MINORITY SMALL BUSINESS COMMUNITY. OUR RESTRICTED INVESTMENT POLICY CARRIES WITH IT AN INHERENTLY HIGH LEVEL OF RISK. ASKING US TO INCREASE THAT RISK BY ACCEPTING DEBT SERVICE OBLIGATIONS ON ALL OUR MONEY WHILE CONTINUING TO MAKE EQUITY INVESTMENTS MAKES OUR JOB IMPOSSIBLE. RESPONSIBLE PORTFOLIO MANAGEMENT DICTATES THAT IF WE MUST COMMIT TO MAKING REGULAR INTEREST PAYMENTS TO OBTAIN OUR MONEY, WE MUST ALSO CHARGE SMALL BUSINESSES REGULAR INTEREST PAYMENTS TO COVER OUR COSTS. IN OTHER WORDS, WE ARE FORCED TO BECOME STRAIGHT LENDERS. THAT WAS NOT THE ORIGINAL PURPOSE OF THE MESBIC PROGRAM, AND I DON'T BELIEVE YOU WANT IT TO BECOME OUR PURPOSE NOW. THE MINORITY SMALL BUSINESS COMMUNITY NEEDS THE EQUITY FINANCING WE ARE ABLE TO PROVIDE THROUGH THE AVAILABILITY OF PREFERRED STOCK LEVERAGE.

SECOND, THE PROPOSED MESBIC GUARANTEE PROGRAM IN NO WAY SUBSTITUTES FOR PREFERRED STOCK LEVERAGE. IT WOULD MAKE FUNDS FOR MESBICS SIGNIFICANTLY MORE EXPENSIVE, AND THERE IS NO GUARANTEE THAT THE FUNDS WOULD BE MADE AVAILABLE. IN ITS PROPOSAL, THE ADMINISTRATION APPEARS TO ASSUME THAT THE SBIC FUNDING CORP. HAS ACCESS TO UNLIMITED FUNDS. THIS ASSUMPTION IGNORES THE ELEMENT OF RISK IN THE PROFILES OF MESBICS AND SBICS. UNDER OUR PRESENT FUNDING SYSTEM, WE RECEIVE $39 MILLION IN DIRECT FUNDING IN THE BUDGET, AND WE KNOW THAT FULL $39 MILLION WILL BE AVAILABLE. ON THE OTHER HAND, SBIC ACCESS TO FUNDS HAS FALLEN OFF SIGNIFICANTLY SINCE THEY MOVED INTO THE SBIC FUNDING CORP. ALTHOUGH PART OF THE REASON FOR THIS MAY BE DUE TO START-UP CONSIDERATIONS, PART OF IT UNDOUBTEDLY CAN BE ATTRIBUTED

TO A WEEDING-OUT PROCESS TO MAKE THE CORPORATION'S OFFERING MORE ATTRACTIVE TO THE MARKET. GIVEN THE FACT THAT MESBICS TEND TO BE LESS HEAVILY CAPITALIZED THAN SBICS, THEY DON'T INVEST IN GENERAL MARKET COMPANIES, AND THEIR INHERENT LEVEL OF RISK IS HIGHER, WE ARE UNDERSTANDABLY CONCERNED THAT THE MAJORITY OF MESBICS WOULD BE "WEEDED OUT" OF THE CORPORATION'S OFFERINGS.

THE MECHANICS OF THIS FUSION OF MESBICS INTO THE SBIC FUNDING CORP. ARE ALSO UNCLEAR. ALTHOUGH WE HAVE TRIED TO GET MORE DETAILS ON HOW THE PROPOSAL WOULD WORK, THEY DO NOT SEEM TO BE AVAILABLE. THE ADMINISTRATION WANTS TO LOWER THE SBIC GUARANTEE LEVEL FROM 100% TO 90%. WILL THIS APPLY TO MESBICS TOO? WILL THEY HAVE DIFFERENT STANDARDS FOR PARTICIPATING IN OFFERINGS? WHAT WILL HAPPEN TO MESBICS THAT JOINED THE INDUSTRY ASSUMING THE AVAILABILITY OF PREFERRED STOCK LEVERAGE, BUT WHO HAVE NOT YET HAD THE OPPORTUNITY TO OBTAIN THAT LEVERAGE?

EVEN IF WE ASSUME MESBICS WILL HAVE ACCESS TO $14 MILLION IN FUNDING THROUGH THE SBIC FUNDING CORP., THESE HIGH COST FUNDS HARDLY CAN BE CONSIDERED A SUITABLE REPLACEMENT FOR OUR RELATIVELY LOW-COST PREFERRED STOCK LEVERAGE. IN THE CORPORATION'S LAST OFFERING, IT PAID 80 BASIS POINTS OVER COMPARABLE TREASURY RATES, OR 7.95%. THE ADMINISTRATION IS PROPOSING AN ADDITIONAL 1% GUARANTY FEE ON SBIC GUARANTY APPROVALS, AND TO DECREASE THE GUARANTEE LEVEL FROM 100% TO 90%. EACH OF THESE PROPOSALS WILL INCREASE THE COST OF FUNDS TO INVESTMENT COMPANIES. INTRODUCING THE HIGHER RISK MESBIC PORTFOLIOS INTO THE CORPORATION'S OFFERINGS PROMISES TO DRIVE UP THE COST OF FUNDS EVEN HIGHER. THE

ADMINISTRATION IS OFFERING TO REPLACE 3% PREFERRED LEVERAGE WITH DEBT OBLIGATIONS THAT WOULD APPEAR TO COST AROUND 10%. BY NO STRETCH OF THE IMAGNATION COULD THIS PROPOSAL BE CONSIDERED A SUITABLE REPLACEMENT.

FINALLY, EVEN IF WE WERE TO GO SO FAR AS TO ASSUME THE PROPOSED MESBIC GUARANTEE PROGRAM WOULD WORK AND THAT MESBICs COULD AFFORD TO USE IT, THE COMBINED DIRECT GUARANTEED FUNDS OF $34 MILLION ARE GROSSLY INSUFFICIENT TO SUSTAIN THE INDUSTRY. IN 1982, THE MESBIC INDUSTRY RECEIVED $46 MILLION IN LEVERAGE. EVEN AT THAT LEVEL, FUNDING WAS INSUFFICIENT TO SERVICE ALL THE LEVERAGE APPLICATIONS. SINCE THEN, MESBIC FUNDING HAS STEADILY DECREASED TO ITS PRESENT LEVEL OF $39 MILLION. AFTER SEVERAL YEARS OF INSUFFICIENT FUNDING, WE HAVE A LEVERAGE APPLICATION BACKLOG OF ABOUT SIX MONTHS. DECREASING OUR FUNDING BY $5 MILLION, OR 13%, WILL EXACERBATE THAT BACKLOG PROBLEM. IF WE DROP OUR ASSUMPTION THAT THE MESBIC GUARANTEE PROGRAM WILL WORK, HOWEVER, MESBIC FUNDING WILL BE CUT IN HALF. THIS CUT WOULD PRODUCE A STRANGLING LEVERAGE BACKLOG THAT WOULD FORCE MANY MESBICs - AND THE COMPANIES THEY FINANCE - OUT OF BUSINESS.

LOOKING BEYOND THE ADMINISTRATIONS BUDGET PROPOSAL ITSELF, I AM INCLINED TO QUESTION ITS INTENDED PURPOSE. MOST BUDGET PROPOSALS ARE AIMED AT BUDGET CUTS. THIS PROPOSAL, HOWEVER, PRODUCES VERY LITTLE IN BUDGET SAVINGS WHILE SIGNIFICANTLY DISRUPTING THE PROGRAM'S STRUCTURE. WHY DOES THE ADMINISTRATION WANT TO ELIMINATE PREFERRED STOCK LEVERAGE? THE ANSWER WOULD APPEAR TO BE A PHILOSOPHICAL - RATHER THAN BUDGET CUTTING

-MOTIVE. IT WOULD SEEM THAT EITHER THE ADMINISTRATION HAS DECIDED IT NO LONGER WANTS TO PROMOTE EQUITY INVESTMENTS IN THE MINORITY SMALL BUSINESS COMMUNITY, OR THAT IT NO LONGER WANTS TO DO SO THROUGH ITS OWN EQUITY INVESTMENTS. OPTIMISTICALLY, I WILL ASSUME THE LATTER TO BE THE CASE.

DURING THE DISCUSSION LAST YEAR CONCERNING LEGISLATION TO CREATE THE CORPORATION FOR SMALL BUSINESS INVESTMENT (COSBI), THE ADMINISTRATION IS SAID TO HAVE REFERRED TO MESBIC PREFERRED STOCK AS A GRANT. I WOULD LIKE TO TAKE THIS OPPORTUNITY TO DISPEL THAT MYTH. EVERY COMPANY WITH PREFERRED STOCK LEVERAGE IS OBLIGATED TO PAY ACCUMULATED DIVIDENDS TO THE SBA BEFORE ANY DISTRIBUTION CAN BE MADE TO ITS OTHER SHAREHOLDERS. NO PRIVATE INVESTOR CAN MAKE A PROFIT FROM A MESBIC UNTIL THE GOVERNMENT IS PAID - PREFERRED STOCK HAS A PRIOR CLAIM OVER ALL THE PRIVATE SECTOR INVESTMENTS. BY SUGGESTING THE PREFERRED STOCK LEVERAGE IS A GRANT, THE ADMINISTRATION IS SAYING THAT ALL THE COMMON STOCK INVESTMENTS IN MESBICS ARE EVEN LESS THAN GRANTS. THE PRIVATE SECTOR HAS INVESTED OVER $170 MILLION IN THE MESBIC INDUSTRY. I CAN ASSURE YOU THAT $170 MILLION INVESTMENT WAS NOT MADE ON THE ASSUMPTION THAT THE FUNDS WOULD BE A GRANT. THAT $170 MILLION INVESTMENT WAS MADE FOR THE SAME REASON SYNCOM MAKES ALL ITS INVESTMENTS -- BECAUSE OF A BELIEF THAT THERE IS MONEY TO BE MADE IN INVESTING IN THE MINORITY SMALL BUSINESS COMMUNITY.

AS AN EXAMPLE OF ONE OF OUR SUCCESSFUL INVESTMENTS, I WOULD LIKE TO CITE CONNECTION COMMUNICATIONS, WHICH OWNS AND OPERATES THE NEWARK, NEW JERSEY CABLE TELEVISION FRANCHISE, THE LARGEST

MINORITY CABLE FRANCHISE IN THE COUNTRY. TWELVE MESBICs, INCLUDING MY OWN, SYNDICATED TWO STAGES OF FINANCING TOTALLING $3.8 MILLION IN EQUITY AND SUBORDINATED DEBT IN CONNECTION COMMUNICATIONS, LEVERAGING AN ADDITIONAL $7 MILLION IN SENIOR DEBT FROM PHILADELPHIA NATIONAL BANK AND PRUDENTIAL INSURANCE COMPANY. THE COMPANY WAS BOUGHT OUT LATE LAST YEAR, PRODUCING A PROFIT FOR THE FOUR MINORITY FOUNDERS OF THE COMPANY, AND FOR THE INVESTORS WHO WERE WILLING TO BE THERE WITH THE SEED CAPITAL.

SYSTEMS MANAGEMENT AMERICAN CORPORATION -- NUMBER 9 ON BLACK ENTERPRISE'S "TOP 100" BLACK BUSINESSES LIST -- HAD 40 EMPLOYEES AND SALES OF $500,000 ANNUALLY IN 1975 WHEN NORFOLK INVESTMENT COMPANY, A VIRGINIA-BASED MESBIC, DECIDED TO TAKE A RISK WITH THE COMPUTER SOFTWARE AND HARDWARE COMPANY. THE MESBIC'S EQUITY INTEREST WAS BOUGHT OUT BY THE ENTREPRENEUR, AND ALL DEBT WAS RETIRED BY 1984. TODAY, SMA'S 600 EMPLOYEES OPERATE IN OFFICES IN THE NORFOLK, VIRGINIA HEADQUARTERS, WASHINGTON, D.C., SAN DIEGO, HAWAII AND GERMANY. SMA SALES HAVE INCREASED TO OVER $30 MILLION ANNUALLY.

SEVERAL MESBICs HAVE PROVIDED FIRST AND SECOND ROUND FINANCING TO VST LABS, A MICHIGAN-BASED MACHINE VISION COMPANY THAT MANUFACTURES A HIGH RESOLUTION CAMERA FOR USE IN INDUSTRIAL OPERATIONS. THE COMPANY HAS THE LEADING OPTICS EXPERT IN THE MIDWEST, AND THE PRODUCT HAS SUCH HIGH RESOLUTION IT CAN BE USED TO DETECT SMALL BONES IN SEALED SOUP CANS. IN ADDITION TO PROVIDING FINANCING, THE INVESTORS ARE CURRENTLY WORKING WITH VST LABS TO PRODUCE AN AGGRESSIVE MARKETING PROGRAM.

In terms of low technology investments, The Combined Fund, Inc. a Chicago-based MESBIC, has financed the largest minority owned fast food franchises in the country. They financed a chain of 17 Burger Kings and the first four McDonald's purchased by an entrepreneur who eventually brought his McDonald's holdings up to eight. E. Patric Jones, President of The Combined Fund and former NAIC chiarman, is attracted to franchise investments because of their built-in management systems and long term potential, and because investments in fast food and other franchises have such a significant yield in jobs for minorities -- especially young people in areas where unemployment reaches 50%.

These MESBIC investments show that we already have made significant contributions to the minority small business community, that our current investments promise to continue to do so in the future, and that we help to provide much - needed employment and management training opportunities to minorities. In order to continue to do so, however, we need continued funding stability, with preferred stock leverage as part of that funding.

In summary, I urge you to recognize the Administration's budget proposal for what it is -- a proposal to eliminate the MESBIC program. This is consistent with their proposals over the past few years, as they have tried to eliminate us along with the entire Small Business Administration. They apparently have changed their strategy to a program - by - program attack, but

THE END RESULT IS STILL THE SAME FOR US, AND FOR THE MINORITY SMALL BUSINESS COMMUNITY WE SERVE.

BY ELIMINATING OUR PREFERRED STOCK LEVERAGE, THEY INHIBIT OUR ABILITY TO MAKE LONG TERM PATIENT EQUITY CAPITAL AVAILABLE TO MINORITY SMALL BUSINESSES. BY REPLACING OUR LOWER COST PREFERRED STOCK LEVERAGE WITH HIGH COST SBIC FUNDING CORP. LEVERAGE, THEY FORCE US TO CHARGE RATES ON OUR MONEY THAT ONLY A FEW MINORITY BUSINESSES WOULD BE WILLING OR ABLE TO PAY. AND BY DECREASING OUR FUNDS BY AS MUCH AS ONE-HALF THE PREVIOUS LEVEL, THEY CREATE A LEVERAGE APPLICATION BACKLOG THAT WILL FORCE MANY MESBICS OUT OF BUSINESS. I URGE THE MEMBERS OF THE SMALL BUSINESS COMMITTEE TO OPPOSE THE ADMINISTRATION'S BUDGET PROPOSAL.

THANK YOU FOR THIS OPPORTUNITY TO APPEAR BEFORE YOU TODAY. I WOULD BE HAPPY TO ANSWER ANY OF YOUR QUESTIONS.

The CHAIRMAN. Mr. Weidman.

STATEMENT OF RICHARD F. WEIDMAN, DIRECTOR OF GOVERNMENT RELATIONS, VIETNAM VETERANS OF AMERICA, WASHINGTON, DC

Mr. WEIDMAN. I want to thank you for letting Vietnam Veterans of America to present our testimony here today on the proposed fiscal year 1988 budget. I am not going to read my testimony and ask that it be entered in the record in full, Mr. Chairman.

I did want to comment on a number of things. As Appendix III to our statement here today, we attach the executive summary, which is the results of approximately $1 million and 13 different studies that were initiated by the SBA in fiscal year 1983.

The reason why that is connected to that, Mr. Chairman, is that in order to explain why we oppose the lowering of the percentage in the guaranteed loan program, and the raising of the points, doubling of the points from two to four, no matter how you slice it, it is in fact a doubling of it. And to keep the 9772 direct programs to Vietnam Veterans as well as the handicapped and minority programs, comes back to this report.

The findings found that 25 percent of veterans, of Vietnam veterans are self-employed as opposed to our non-veteran cohorts. That veterans owned businesses in general, across the generations are younger, smaller, and more in need of capital. At the same time, up to between 700,000 and a million Vietnam era veterans are interested in going into small business. But those that are having the greatest difficulty are those who in fact are service connected disabled veterans.

The difficulty of all the veterans, as has been noted in all of these studies, which are the Executive Summaries I said I would attach as an appendix, is amassing initial capital. While the 9772 Direct Loan Programs to Veterans only helps 250 to 300 veterans a year, in fact that is the reason the program is there is to help those folks who have no recourse any place else. A significant portion of those folks are in fact disabled. Were the Handicapped Program, used particularly for catastrophically disabled Vietnam veterans, I believe it could be an extremely good use of that Fund.

Over 25 percent of all guaranteed loans in fiscal year 1986 went to veterans of one generation or another. And so what our problem here is, is that we believe that a lot of that, almost 29 percent of veterans who got those, once again, I come back to the results of the study, Mr. Chairman. Because our businesses are younger, smaller, and more in need of capital suffer from the difficulty of amassing collateral and equity, and are really on the margin as to whether or not they are going to qualify for those direct loans or not.

Even that slight raise in the cost, and in the lowering of guarantee percentages is going to throw additional stringency on the way in which the financial institutions look at the collateral and equity of our individuals. What that means, bluntly, is that a lot of our folks are going to get cut out in being able to qualify for a loan.

The difficulty that we have, Mr. Chairman, in the past, we have always advocated that the, and hit hard on the fact that we believe

management assistance and training, hands-on training, is really the crux of the issue of what the SBA can do for veterans. The difficulty that we have there, is that they are not doing a very good job of that either. And from fiscal year 1986, or fiscal year 1985 and 1986, had a 56 percent drop in the number of folks that they, veterans that they served. Every time we say that, about management assistance being the crux of it, they come right back and use that as a weapon on us to try and knock us out of the access to capital programs, which in fact are relatively miniscule in terms of overall access to capital. But at the same time, they are extremely vital to us. I just want to say that I think the budget submission is in fact, goes absolutely against the representations that have been consistently made to us over the course of, particularly in December and January, and then to date. That the SBA, from this point forward to move forward assiduiously to make special consideration to veterans a reality at the SBA.

When you look back at the hard numbers, the cutting of the SBDCs and at the same time, trying to knock us out of access to capital, so that at the same time, they are reducing the management assistance side of it, delivery of mechanisms, they are making it that much more difficult for Vietnam veterans and veterans of any generation to have access to the capital markets.

Mr. Chairman, I hope that with your leadership, that has been exhibited by you and the rest of this Committee in making an SBA exist for us to be talking about here today, that you will be able to get a philosophic turnaround. Get Senator Abdnor on board as Administrator, and begin to provide that kind of positive leadership to rebuild what, in fact, has been a shattered agency over the course of the past couple of years.

Thank you once again, Mr. Chairman, for your past leadership.

[The prepared statement of Mr. Weidman follows:]

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STATEMENT

OF

RICHARD F. WEIDMAN
Director of Government Relations

Vietnam Veterans of America

on

President's Proposed FY 1988 Budget

Before the

Committee on Small Business

United States Senate

February 24, 1987

Mr. Chairman, my name is Richard Weidman, and I am currently serving as Director of Government Relations of Vietnam Veterans of America (VVA). VVA is grateful to you and to the Committee for the strong support you have demonstrated on behalf of "special consideration" for veterans, pursuant to Public Law 93-237. Vietnam Veterans of America appreciates the opportunity to appear here today to present our views on the President's proposed FY 1988 Budget for the U.S. Small Business Administration.

BACKGROUND

The history of the Small Business Administration's (SBA) response to veterans since the passage of P.L. 93-237 in 1974 can fairly be characterized as a checkered history at best. Relatively little was done until 1980 when, thanks to the presure of this Committee, "The Pechin Report" was commissioned and completed. That document, so-called because it was prepared under the supervison of James E. Pechin, became the blueprint for virtually everything of useful substance that has occurred at the SBA for veterans since. The problem was (and is) that while everyone agreed that the findings of the Pechin Report were valid, virtually none of the recommendations were implemented.

In 1981, the Small Business Administration convened a "Task Force on Special Consideration for Veterans." I served as co-chair of the Subcommittee on Management Assistance and Training, sharing that duty with Mr. James Sanders, who was to become Administrator of the SBA in early 1982. In May of 1982, Administrator Sanders

signed the order implementing P.L. 93-237. The Office of Veteran Affairs was created, under the direction of Steve Mollett. A good deal was accomplished in the next two years, although the effort was not as comprehensive or concerted as many who were knowledgeable in this area believed was neccesary to really provide the services that are neccesary. Mr. Mollett became terminally ill, and the SBA became a target for destruction by the President and his Office of Management and Budget. The question in 1984-5 and again 1986 became not whether the SBA was properly responsive to veterans, but rather whether or not the SBA would exist at all. There has to be an Agency before it can be properly responsive to veterans. Along with many others, VVA advocated retention of the SBA. Thanks primarily to the efforts of this Committee, the SBA was preserved from immediate destruction. However, while the attempt by the current Administration to outright destroy the SBA has clearly been thwarted, the effort to reduce the effectiveness of the agency in order to diminish the level of service and weaken constituency support of SBA continues unabated. While there have been some recent positive gestures toward veterans by the SBA, the clear overall intent of the current Administration's proposed FY 1988 Budget is to further weaken the SBA and damage the infrastructure of the agency, with a view toward eventual destruction of the Small Business Administration.

DIRECT LOANS TO VETERANS PURSUANT TO P.L. 97-72

The Administration has again proposed to eliminate direct

loans to veterans. This program, which is designed to make capital available to Vietnam veterans who qualify, and who cannot obtain it elsewhere, has worked well, although it has been generally under-utilized by SBA. Less than $75 million of the $115 million appropriated for this program since its inception in 1983 has been utilized. The SBA did utilize all of the funds appropriated in FY 1986, and the funds for the first quarter of FY '87 have been fully expended. (See Appendix I) This is a very modest program, which assists about 250-300 veterans per year at the current funding level. The number and percentage of these high risk loans that result in unrecovered assets to the government is relatively low. VVA has always held the position that SBA should not relax the overall rigor of guidelines that are used in disbursment of the 97-72 loans. VVA has consistently maintained that the crux of what the SBA can and should do for veterans is to provide resources that include specific "hands-on" training in accounting, management, marketing, and access to opportunities to learn other actual skills necessary to successful small business operation. VVA favors continuance of this program, with much more in the way of supportive services.

The Small Business Administration contracted for a number of studies in FY 1983 under the general heading of "Veterans and Entreprenaurship." The "Section II: Summary of Major Findings and Recommendations" is inlcuded as Appendix III of this statement. You will note that one of the major characteristics found is that "Veteran-owned businesses are younger, smaller, and more in need of start-up capital than non veteran-owned businesses." The need is

clear and documented by the SBA itself. Rather than trying to eliminate this direct loan program, the Administration should concentrate on trying to do a better job of servicing the veterans who qualify for and actually receive loans under this program, or from other sources.

7(a): REDUCTION IN GUARANTY PERCENTAGE AND RAISING GUARANTY FEES

Vietnam Veterans of America is against both the reduction in Guaranty Percentage and the proposed hike in the fee for loan guaranty. As noted previously, veteran owned businesses tend to be smaller and more in need of start-up capital. Veteran-owned businesses also tend to have significantly more problems with amassing equity and collateral neccessary to securing neccessary financing. The proposed reduction in the guaranty percentage from 90% to 75% for loans in the $75,000 to $174,285 range would have particularly adverse impact on veterans, especially Vietnam veterans, as the majority of SBA guaranteed loans to veterans fall within this range. The increased fee, obviously, would make these loans more expensive but would have the additional impact of pricing many veterans out of the market. VVA would point out that while all of the data on SBA loan programs document that veterans are overall a significantly better credit risk than non veterans, this is largely because of tenacity more than anything else. The margin of difference in the monthly payment will be, in many cases, just enough to preclude veterans access to the capital neccesary to start or expand their business. Further, lowering the percentage

of guaranty will inevitably cause greater emphasis and stringency in application of equity and collateral guidelines, which are a significant barrier for a great number of veterans.

SALE OF ASSETS

Mr. Chairman, Vietnam Veterans of America (VVA) would also note that the proposed sale of Assets for FY 1988 is ill advised in the form that we understand it will take. The Administration is proposing to sell approximately $1.5 Billion of General Business and Development Company Loans and $800 Million of Disaster Loans from the SBA portfolio, and to make all such sales "without recourse." VVA would point out that the General Accounting Office (GAO) has deemed this proposal to be unwise in its return to the Government. In essence, the Administration is proposing a "fire sale" with no fire. GAO stated that OMB's policies in this regard "will result in program objectives not being fully achieved." (GAO/AFMD - 86 - 79; "Loan Asset Sales"; September 25, 1986.) VVA endorses GAO's prudent recommendation that the Small Business Administration sell loans from their portfolio on a "structured basis, which would inlcude some form of future recourse to the grovernment." This would result in a reasonable and proper return to the Government.

SMALL BUSINESS DEVELOPMENT CENTERS (SBDC)

The proposed reduction in the statutory cap on funding for

Small Business Development Centers from $65 to $45 million for FY 88 is a move which is antithetical to the needs of veterans and others who need effective assistance in acquiring business skills. Further, the Administration proposes to immediately defer $4.1 million of appropriated funds, place a moratorium on formation of new SBDCs, and phase out Federal involvement over the next five years. Vietnam Veterans of America (VVA) has always maintained that the most important thing that the SBA (and any of its funded programs) can do for Vietnam and disabled veterans is to provide opportunities to learn the skills neccesary to success in business. As important as access to adequate capital is, management assistance and training is the most important priority. This Administration seems to like that message, but uses it only as a weapon for them to justify destruction of capital access programs. The Small Business Development Centers should not only be preserved, at least the current level of appropriated funds, but "special consideration" for veterans written in to contracts with specific SBDCs as they come due for renegotiation.

CONCLUSION

Mr. Chairman, the FY 1988 Budget for the Small Business Administration (SBA) which has been proposed by the President makes some show of preserving the SBA as a viable independent agency. However, there are many elements in it, ranging from the proposed elimination of direct loans to handicapped, minorities, and veterans to the proposed destruction of the SBDCs, that lead us to

wonder at their true intent. The stated intent is to preserve and "streamline" the SBA, but it begins to appear that the true intent is to further weaken and demoralize the Agency, with a view toward eventual elimination. We would hope that this Committee, under your strong leadership, Mr. Chairman, will ensure that the damage of the last few years begins to be repaired. We would certainly hope that the speedy appointment and confirmation of the Honorable James Abdnor as the new Administrator will help provide the positive leadership the SBA needs at this point.

Mr. Chairman, that concludes our statement. I would be pleased to answer any questions you may have. Thank you for allowing the Vietnam Veterans of America to present our views here today.

APPENDIX I
VVA
2/24/87

PL 97-72 DIRECT LOAN PROGRAM DATA

Fiscal Year	Funding Level	Amount Lent
1983	$ 25 million	$ 8.4 million
1984	25	19.8
1985	25	8.6
1986	20	19.1
1987	19.1	19.1 (Est.-All funding for 1st quarter used)

CURRENT PORTFOLIO STATUS - 1983 TO DATE

Loan Status	Number	Dollars
Current	408	$27.3 million
Past due	44	2.6
Delinquent	74	5.0
In Liquidation	119	7.3

Average Loan Size - $64,000

SBA COMPARATIVE LOAN STATISTICS
LOANS TO VETERANS

		1980	1981	1982	1983	1984	1985	1986
Appropriation	Direct	364,000	325,000	184,000	200,000	176,300	185,000	38,280
	PL 97-72	--	--	--	25,000	25,000	25,000	19,140
	Guaranty	3,405,000	4,358,000	2,575,000	2,940,000	3,030,000	3,180,000	2,950,360
Total All Loans	Direct	360,068	291,688	150,029	125,097	145,016	129,070	47,028
	Guaranty	3,037,662	2,902,498	1,628,820	2,438,730	2,857,597	2,656,923	2,515,788
Loans to Vietnam-era Veterans	Direct	23,693	25,100	16,902	9,629	22,812	11,874	1,391
	PL 97-72	--	--	--	8,411	19,847	8,634	19,098
	Guaranty	135,072	186,030	156,915	275,872	296,097	275,675	306,180
Loans to Other Veterans	Direct	19,211	19,800	17,407	15,122	15,056	10,467	2,156
	Guaranty	237,753	318,326	200,970	335,833	377,723	333,178	306,540

(Figures are $$ in thousands)
FY 1986 figures through September 30
based on preliminary figures.
Guaranty figures are SBA share.

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APPENDIX III
VVA
2/24/87

VETERANS AND ENTREPRENEURSHIP

A RESEARCH DIGEST

SECTION II

SUMMARY OF MAJOR FINDINGS AND RECOMMENDATIONS

II. Summary of Major Findings and Recommendations

A. Overview of the research

While there was some variation in the findings and conclusions within the research, veterans were determined to be less likely than nonveterans to go into business for themselves. Some differences were found in the relative financial performance of veteran and nonveteran-owned businesses and a signif. ..t difference between veterans and nonveterans was found in the type of business selected. Vietnam-era veterans indicated a definite but latent desire to go into business for themselves.

The research describes the average entrepreneur as a white male in his late 40's with a college degree. His chief motivation is the desire to be independent and to face the challenges of working for himself. Most veteran entrepreneurs have worked for someone else, and prefer starting their own business rather than buying an existing one. Minorities and women are a very small part of the entrepreneur population, veteran or nonveteran. However, veteran minorities and women, upon becoming part of the wage-earning population, earn substantially more than their nonveteran counterparts.

The studies which specifically compared demographic and financial characteristics of veteran and nonveteran entrepreneurs found that while veterans are older and better educated than nonveterans, they start and own smaller businesses, need more capital, and earn somewhat less than their nonveteran counterparts. It was determined that veterans are most likely to start businesses in the manufacturing, retail, wholesale and service industries and least likely to enter the finance, insurance and real estate industries. Likelihood of success as tied to geographic and industrial dispersion is similar for veterans and nonveterans.

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Veterans who are wage earners tend to work longer hours and more weeks per year than nonveteran wage earners and to go into jobs which correlate with what they did in the military (e.g., pilots, airplane mechanics, police, etc.) Additionally, minority veterans in all age categories earned substantially more in wages than their nonveteran peers.

Entrepreneurs need resources to achieve business success. These resources can range from technical assistance such as accounting, management, marketing, research, and counseling services to access to financing and investment capital. Research findings indicate that substantial resources and assistance are available from public as well as private agencies and institutions and that veteran entrepreneurs do utilize such assistance from the SBA, VA, public interest groups, military, educational, financial, legal and social institutions. Assistance takes the form of management counseling, training, financing, discounted or free services, special access to limited markets and business contracts.

The research also indicates that veterans and nonveterans who use both SBA and non-SBA resources, rate the latter better than SBA assistance. However, SBA products and services are rated as fairly effective. It was noted that those veterans whose businesses perform well had substantially better perceptions of SBA assistance than those whose businesses were faltering. Disabled and minority veterans are more likely than non-disabled, white veterans to use SBA services. Veterans who receive multiple SBA services, (e.g., counseling, technical assistance, research and training) are more likely to increase their performance level than those who receive a single type of service.

Informal investment (risk capital) was determined to be an important potential source of funding for small start up firms, since there is virtually no shortage of informal capital funds available. Veteran-owned businesses, therefore, should direct more of their corporate development efforts towards finding informal investors who have a ready supply of capital and a willingness to invest in both start-up and expansion of existing firms. Findings indicated that informal risk capital is a workable resource available to entrepreneurs in quantities greater than currently used. However, venture capital investors did indicate dissatisfaction with the information channels available to them to identify potential investment opportunities.

Research on SBA loans to veterans concluded that performance or "payback" of SBA guaranteed loans depends on the economic growth rate of the industry to which the business belongs, as well as the economic growth rate of the geographical region in which the business resides. It was recommended that SBA study why its direct loan program to veterans had such a relatively poor performance record.

Research on Defense Department (DOD) contracts found that there is no difference in the degree to which veteran firms are awarded defense contracts by size of contract or type of product or service; and, that there is virtually no difference between the quality of work performed by veteran and nonveteran-owned firms. This does not mean, however, that there is no intrinsic benefit to be derived from having a veteran preference factor present in awarding DOD contracts.

It was found that disabled male veterans are less likely than non-disabled males to be successful in their business activities and to become full-time

entrepreneurs. The research indicates that disabled veterans are more likely to be self-employed on a part-time basis in smaller and lower capital and venture businesses than the non-disabled entrepreneur. The VA's system of evaluating and rating disabilities is seen as a major disincentive for veterans, especially the more severely handicapped, because they are either uncertain as to the extent to which their self employment income will reduce their disablility rating and benefits or they know the trade-off and prefer to stay with their guaranteed VA compensation.

B. A Discussion of Methodology and Conflicting Findings

Due to the differences in the study populations, the data bases and statistical techniques used, and the exact questions asked, it is difficult to compare specific findings and conclusions of individual studies with each other. No major conflicting results were noted among the studies; most of the differences in findings could be explained by differences in the sample, the survey instrument, or the interpretation of individual responses.

Some of the studies came up with apparent contradictory findings simply because they had collected and analyzed similar but not completely matching data. Seemingly contradictory results were noted among "Profiling Entrepreneurial Veterans," "Entrepreneurial Choice and Success," and "Veterans' Needs for Management Assistance" because of slight differences in response rates, what the individual researchers considered a meaningful finding, and the statistical significance of those findings.

Some contradictions in study findings came about because of differences caused by sample selection methodology. "Entrepreneurial Choice and Success"

considered two population groups, nonveterans and all veterans combined, as did "Differences Between Veteran and Nonveteran-Owned Businesses." Profiling Entrepreneurial Veterans" studied nonveterans, World War II, Korean, and Vietnam War veterans who were alumni of business schools while "Financial Success and Business Ownership Among Veterans" used the same population breakdown but without using business school as a selection factor and also separated out those veterans who had served between the Korean and Vietnam eras. "Vietnam-Era Veterans and Entrepreneurship," of course, concentrated on only the Vietnam-era veteran with an emphasis on the disabled veteran, while "Veterans' Needs for Management Assistance" used population categories of nonveterans, veterans in general, and Vietnam Veterans.

The differing population and education groupings, as well as the size of the groups and the different focuses of each study, reduced the replication value of the research. While the general emphasis of the studies was roughly the same, each study differed in one or more substantial ways.

C. Specific Findings and Recommendations

Numerous findings and recommendations were contained in the nine studies. Some of the most useful and valuable findings relative to Federal policy formulation and program design for veterans were:

1. Principal Findings:

a. Characteristics of Entrepreneurs

- Most entrepreneurs are white, male, nonveterans, often with some graduate school education.
- The self-employment rate for veterans is about 25% lower than that of the general population. (See: Tables 2, 7, 8, 9, 10) therefore,
- Veterans are substantially more likely than nonveterans to be wage-earners than entrepreneurs. (See: Table 7)

b. Characteristics of Businesses

- Veteran-owned businesses are younger, smaller, and more in need of start-up capital than nonveteran-owned businesses.
- Vietnam veteran-owned businesses are smaller, younger, and need more start-up capital than other veteran-owned businesses.
- Veteran-owned businesses differ significantly from nonveteran-owned businesses in their distribution across industry sectors. (See: Tables 1 and 5)
- Vietnam veteran-owned businesses differ significantly from other veteran-owned businesses in distribution across industry sectors. (See: Table 1)
- Veterans start businesses in industries that tend to have a high concentration of smaller firms.

c. Employment and Income Characteristics of Veterans

- o Veterans tend to select jobs and businesses directly related to the jobs they held in the military.
- o Veterans receive their military training in occupations that traditionally have low civilian self-employment levels.
- o Between 700,000 and 1,000,000 Vietnam-era veterans are projected to show a strong interest in self-employment.
- o Disabled, female and minority veterans were less likely to become entrepreneurs than their nonveteran counterparts. (See: Tables 2, 9, 10, 11)
- o Veterans earn substantially more as wage earners than as small business owners. (See: Tables 3, 4, 6, 12, 13, 14)
- o Self-employed Vietnam-era veterans earned incomes that were somewhat less than the incomes of their self-employed non-veteran counterparts. (See: Table 4)
- o After an initial lag, wage earning nonveterans of each war period had higher incomes than comparable wage earning non-veterans. (See: Tables 3 and 12)
- o Veterans of each war period more frequently hold full-time jobs, are less frequently unemployed, and work more hours per year than nonveterans.
- o White Vietnam-era veteran wage earners earned less than non-veterans of the same age and education by 5.7% per year of service, but this income loss was temporary and later they followed the same higher earning patterns as veterans of previous war periods.

- o For certain veteran subgroups, e.g. minorities, women, high school dropouts, annual wage earnings were substantially higher - up to 36% more income than their nonveteran peers. (See: Table 3)
- o Female veterans earn substantially more in self-employment income and wages than their nonveteran peers. (See: Tables 3 and 4)
- o Disability increases the likelihood that a business will not succeed and probably decreases the chance of survival beyond 3 years.
- o Disabled veterans who are self-employed are more likely than other male, self-employed individuals to be self-employed part-time, have fewer employees, and generate lower earnings. (See: Tables 4 and 12)

d. Other Findings

- o Guaranteed SBA loans perform better than direct loans.
- o There seems to be no shortage of informal risk capital funds, nor an unwillingness to provide funds to small or veteran-owned businesses but channels of communication are weak. (See: Table 21)
- o In SBA's sunbelt regions, 4.7% of small businesses had informal investors.
- o Veteran informal investors, especially Vietnam veterans, tend to invest in veteran-owned businesses. (See: Table 22)
- o Both entrepreneurs and non-entrepreneurs have doubts about the effectiveness of current Federal small business assistance programs.

- SBA is not meeting the needs of Vietnam veterans because of the low quality of services and limited program promotion.

2. Specific Recommendations

- SBA needs to make its services and programs better known to the small business community, veterans organizations, and members of the Armed Services approaching separation or retirement.
- SBA Central Office should train its field office staff in more effectively assisting veterans, encourage prompt and consistent response to veteran inquiries and streamline operations, perhaps offering "one-stop shopping", especially for the disabled veteran.
- SBA should develop, at the local District Office level, contacts, channels of communication, and financial information on and with informal investors to assist veterans in tapping that vast source of high risk equity financing.
- SBA should design and conduct training programs for veterans to develop strategies to successfully negotiate financing/ownership contracts with informal investors.
- All SBA management courses should be professional, intensive, include hands-on experience, and as possible, be offered through the assistance of SCORE or other successful volunteers. SBA and business or trade schools should consider working together, perhaps through the Small Business Development Center program.

- o SBA should develop training programs that address the management problems of small, undercapitalized firms in their early stages of growth, with less than 20 employees.
- o Networking or support programs like the Veteran Business Resource Councils should be expanded and encouraged to provide assistance to veteran business owners.
- o Other Federal agencies should consider monitoring the level of participation of veteran-owned firms in Federal procurement programs. (See: Tables 17 and 18)
- o The impact of the VA rating system on the entrepreneurial initiative of disabled veterans should be studied. Veteran affairs information should be shared with the VA and discussions held about possible joint programs.
- o SBA should review the performance of the Handicapped Assistance Loan-2 Program and determine if there are distinct patterns of use by degree and type of disability and if these veterans need special assistance from the VA or SBA.
- o Modifications to the 8(a) Minority Business Development and Procurement Assistance, and 7(j) Management and Technical Assistance Programs to include Vietnam era veterans and/or disabled veterans should be considered.
- o SBA should use the VA Vet Centers more heavily. SBA should explore with the VA the possibility of providing the services of a loan officer and SCORE representative on a trial basis in selected Veteran Service Centers around the country.

- o SBA should package its financial and management assistance services for veterans and integrate the SBA management assistance program with the loan programs.
- o SBA should evaluate its management assistance to veterans to determine its impact and more clearly identify specific needs.
- o Annual goals for increasing veteran involvement in current SBA programs should be established.
- o Handicapped and minority veterans should be targeted to increase their self-employment rates and earning levels.

And, finally,

- o SBA must make a basic policy decision whether to target Vietnam-era veterans as a priority group for service to raise their self-employment and earning levels.
- o If SBA decides to give Vietnam-era veterans special services, it must provide more resources to meet the demand.
- o If SBA decides against giving Vietnam-era veterans special services, it should re-evaluate its current policy and program of special consideration to all veterans. The current confusion in the message is that while special emphasis is merited, there are insufficient resources. The result is that the Vietnam-era veteran is developing a negative image of the Agency because of unfulfilled expectations. For a more extensive listing of the recommendations from the studies in this Digest, please refer to Appendix B - Recommendations.

The CHAIRMAN. Thank you. I thank all of you for your excellent testimony. I want to say, when people such as you take the time to come here and be with us, and work assiduously on your testimony, I know that sometimes it is dismaying when the Senators, because of their conflicting schedules, can not be here. I wish they could all stay for it. But they depend on the Chairman and the ranking member to take the lead in the markups on these bills and everything. I can tell you that your testimony has been most compelling and very enlightening to me.

I might also say that what you say makes just eminent common sense. I mean, for example, I can tell you that those portfolios are going to be sold after I have done everything in the world I can do to keep them from being sold. I am talking about these fire sale prices. That makes no sense whatever.

In our push to comply with Gramm-Rudman, all of which is a perfectly legitimate thing, and we are all conscious of the deficits, the threat of the deficit, and what to do about it. That is a very poor excuse to do something that is crazy. I intend to do everything I can to see that it does not happen.

Tony and Mark, I certainly intend to do everything I can to make sure that no such fees as 4 percent are imposed. I also find it tragic that the Handicapped and Veterans Direct Loan Programs have been wiped out under this proposed budget. My guess is the bill that comes out of the Senate certainly will not be like that.

So, in short, we have an expression in the South, where somebody in lecturing on something with which you agree, you are preaching to the saved. We are all preaching to the saved here. So we agree. And let me again express my sincere thanks for you coming down to be with us this afternoon. Thank you. The best of luck to you.

NASBIC has a statement that they would like to have inserted in the record and I will do so now without objection.

[The prepared statement of Mr. McNeish follows:]

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PAUL R. WOOD
EXECUTIVE COMMITTEE

February 24, 1987

STATEMENT OF

PETER F. MCNEISH

Before the

COMMITTEE ON SMALL BUSINESS

UNITED STATES SENATE

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

I am Peter F. McNeish, President of the National Association of Small Business Investment Companies (NASBIC), the trade association which represents the Small Business Investment Company (SBIC) industry.

On behalf of the officers and members of NASBIC, we greatly appreciate the opportunity to present testimony on the President's budget proposal for SBA for FY 1988, and commend the Committee for moving expeditiously to examine the specifics of the Administration's recommendations.

Although we have not seen the supporting details for the Administration's budget proposal, we have been advised by SBA of the substance of several provisions dealing with the SBIC and Minority Enterprise Small Business Investment (MESBIC) programs.

First, let me note that while there is some good news in this budget proposal, the predominant message being sent by the Administration is more bad news.

The good news is that after three years of mindless proposals to terminate the SBA and its financial assistance programs, the Administration has submitted a budget that maintains SBA as an independent agency.

That's the positive element of this budget proposal. But, it should be noted that this turn-a-round of the Administration's position on SBA came about only because the nation's small business community and the Congress challenged the Administration on the value of the SBA and its financial assistance programs. This effort culminated at the recent White House Conference on Small Business where 1800 delegates representing the interests of small business from around the nation voted to preserve SBA and its financial assistance programs as one of its top priorities. These men and women made it abundantly clear that small business, which annually accounts for most of the nation's new employment, innovation and economic growth, and which is the driving competitive force behind our economy, would not tolerate another proposal to abolish SBA. It was truly a victory for small business -- based not on politics, but on a recognition of the

worth of SBA and the essential financial support its programs provide to the small business community.

But, Mr. Chairman, we all know that there is more than one way to skin a cat. Even a cursory examination of the Administration's latest budget proposal shows that what it could not accomplish through advocating termination of the SBA, and the SBIC and MESBIC programs along with it, it is attempting to do through other proposals that would destroy our ability to operate efficiently and effectively on behalf of small business.

I know that Herbert Wilkins, Chairman of the National Association of Investment Companies (NAIC), which represents the MESBIC industry, will discuss in detail the serious harm that the Administration's budget proposal will do to the MESBIC industry so I won't go into the specifics of those items. Let me just say that we wholeheartedly concur with and support their position regarding the irreparable damage that the Administration's budget proposal will do to the MESBIC segment of our industry. We believe, as do they, that such a proposal, which cuts in half their funding and eliminates the ability of MESBICs to sell preferred stock to SBA, would deliver a death-crushing blow to the MESBIC industry. We trust, Mr. Chairman, that this Committee will quickly and totally demolish this attack on the MESBIC industry.

With regard to the specific proposals concerning the SBIC program, the Administration's recommendations are equally harmful and misguided.

The Administration's budget submission proposes to "freeze" the funding level for the SBIC program at $233 million for FY 1988. After netting out both (1) the reduction attributable to the requirements of Gramm-Rudman, and (2) the $14 million add-on for MESBIC guarantees, $233 million is the amount of SBIC debentures the SBA would be authorized to guarantee, i.e. the amount of "leverage" available to SBICs.

Is $233 million enough? We think not, although it's only fair to admit that forecasting the industry's liquidity position and need for funds to invest in small firms in 1988 is an uncertain process. SBA may argue that SBICs didn't use all the funds available to them in FY 1986, and that it appears they will not draw down the authorized level in FY 1987 either. While that's factual, it is also true that the lending window for SBICs was completely shut down for over six months, the new funding system has taken another six months to get up and running on a functional basis, and the cloud of uncertainty over the SBA's future has both deterred SBICs from long-term borrowing and inhibited the formation of new SBICs. At the same time, the industry has invested funds at record levels for the past two years. Based on these facts, we would argue that the pent-up

demand for leverage that has been building for the last two years will surface during FY 1988, assuming certainty in the program and an effective system of funding.

Our conclusion is that (in addition to the $14 million for MESBICs) $233 million will fall far short of the necessary funding level, and a higher mark is amply justified. Hopefully, the Corporation for Small Business Investment (COSBI) legislation will be passed during this session of Congress, and the funding ceiling for SBICs and MESBICs will become a moot issue.

Beyond the funding level itself, the Administration has made two additional proposals that would, in effect, make the cost of leverage funds for the industry either inaccessible or prohibitively expensive. I might note, parenthetically, before discussing these two proposals, that the Administration's recommendations come on top of a program change made just last year in P.L. 99-272 that has increased the cost of funds for SBICs by requiring that they go the the public market place for financing rather than to the Federal Financing Bank. That change was adopted -- indeed suggested by the industry -- in order to help this Committee achieve the budget savings necessary to convince the former leadership of the Senate and the Administration to preserve the SBA's important financial assistance programs.

One of the Administration's proposals, we are advised, would change the current 100% government guarantee on SBIC debentures to a 90% gurarantee. The Administration takes the position that

reducing the guarantee to 90% would be in line with their policy of "risk-sharing" in federal credit programs, similar to the 90% guarantee in the 7(a) loan program. What they neglect to recognize is that the structure of the SBIC program already puts SBIC investors 100% at risk before the government loses one thin dime. The idea of applying a "risk sharing," 90% guarantee concept to a program where the private sector already stands to lose all of its capital and assets before the government's position is even 1% at risk is illogical on its face. In a nutshell, this proposal makes no sense whatsoever!

It is also clear that the Administration has not considered what the result of such a proposal would be or the impact it would have on the the ability of the SBIC industry to obtain leverage funds! Does this proposal mean that there would only be a "partial government guarantee" in the event of default? If so, how would it work? Could such a security even be sold in the capital markets? If so, at what cost? One investment banker has advised us that he would not be able to sell such a hybrid security! Another has said that such a security might be salable, but because of its unusual characteristics, it could only be sold at extremely high pricing levels. Under either scenario -- one resulting in SBICs being unable to obtain leverage funds at all through the program, and the other making the cost of financing so high as to make it prohibitively expensive -- the result would be the same: the inability of SBICs to obtain leverage; the erosion of capital for small growth firms; and the eventual demise of the SBIC industry.

In summary, this proposal is consistent with the Administration's position in the past to eliminate or cripple the SBIC program.

A second proposal by the Administration would add an additional 1% "users fee" to the cost of SBIC leverage on top of the current 1.185% users fee, which already pays for all of SBA's current costs to operate the SBIC program. Clearly, there is no justification whatsoever for this added taxation of the SBIC industry. It is simply one more way the Administration has devised to raise the costs of the program and heap more expenses on SBICs to make it prohibitively expensive for the industry to obtain leverage. Unlike the 90% guarantee proposal, which would require the enactment of legislation before it could be implemented, we understand that SBA believes it has the power to implement this proposal through its regulatory powers. We would urge the Committee to take every possible step to prevent SBA from taking any such unilateral action.

Mr Chairman, I might also note that during our meeting with SBA on the budget, we were advised that at some time within the next few weeks the Administration would also be submitting a legislative package to the Congress that would recommend a series of additional amendments to the Small Business Act of 1958 affecting the operations of the SBIC program. Based on a cursory review of these proposals, as described in the budget justification submitted to this Committee, it is clear that the Administration has shifted to a strategy which is designed to incrementally chip away at the SBIC program, piece by piece,

until it is eventually destroyed. The Administration's frontal attack on SBA's credit programs for small business was soundly defeated, but they're still fighting the war. They are attempting to accomplish indirectly what they couldn't do directly. The only thing that's changed is the tactics; the objectives and ideology remain the same. Hopefully, this Committee will send a strong message to the Administration at these hearings that this less-than-artful dodge is simply unacceptable. In addition, if these proposals are submitted to Congress in the form of legislation, or if SBA attempts to implement any of them through regulatory changes, we respectfully request the opportunity to submit to this Committee a full analysis of their destructive impact on small business, the SBIC program and the future of our industry.

Mr. Chairman, clearly the ability of SBICs to obtain leverage funds -- whether through a government guarantee, or, hopefully in the near future through a government sponsored enterprise in the form of the industry's COSBI proposal -- is the lifeblood of the SBIC industry. If SBICs are unable to obtain these funds because they are prohibitively expensive, this is the same as providing no funds to the program at all -- and the result would be the same as if the Administration's previous recommendation to terminate the SBIC program were adopted. This Committee has stood steadfast against permitting such errant proposals in the past, and we trust that the same course will be followed in the future.

Mr. Chairman, we at NASBIC would again like to applaud the efforts that you and the Committee have taken to ensure the continuation of the SBA and its proven programs. We stand ready to assist you in any way in this effort. We still believe that a steady flow of capital to SBICs, at reasonable rates, provides a time-tested investment in the small business community, the economic growth and competitiveness of this nation, and the production of tax revenues well beyond the cost of the program to date.

We pledge to expand our efforts to design a better alternative structure for the SBIC program and, as always, look forward to working with you and the Committee toward that end. You have assured us of reintroduction of our legislative proposal to create a "capital bank" for the SBIC industry -- the COSBI proposal. Indeed, we are especially pleased that you have indicated that COSBI will be a top priority of the Committee this Congress. We look forward to working with you, your staff and the other members of the Committee on this initiative.

In conclusion, we believe that SBA's budget recommendations before you today provide rock-solid evidence of why enactment of COSBI is so critical to the health and future of the SBIC industry.

Thank you for giving NASBIC the opportunity to submit this testimony to the Committee.

The CHAIRMAN. The Committee will stand adjourned until the next call of the Chair.

[Whereupon, at 4:30 p.m., the Committee adjourned, to reconvene subject to the call of the Chair.]

APPENDIX

ALLIED CAPITAL CORPORATION

Investment
Capital for
Growing Business

1666 K Street, N.W., Suite 901, Washington, D.C. 20006 — Tel. (202) 331-1112

February 24, 1987

The Honorable Dale Bumpers
Chairman
US Senate Small Business Committee
229 Dirksen
Washington, D.C. 20510

RE: OMB Proposal for the SBA Budget Plan Commencing October, 1987 (FY 1988)

My dear Senator Bumpers:

Allied Capital Corporation financed Atlantic Research Corporation in its early years and it grew to employ many people in the United States and it has been a great contributor to the US Economy. Every year Allied Capital Corporation finances numerous new small businesses. Last year we financed more than 100 small businesses all over the United States. Now we see that the OMB and the SBA is to curtail one of the greatest programs for helping small businesses that has ever been invented: The SBA Guaranteed Loan Program. The proposals being made by OMB and the SBA would destroy the program for many leiders and make it a mere shell of what it is today. We here at Allied Capital Corporation believe that the proposals that have been submitted by the Reagan Administration for the budget year commencing 1988 involving the SBA Guaranteed Loan Program would be highly detrimental to the capital flow to small businesses and would terminate the ability of many small businesses to be created. The proposals would directly force lenders away from making SBA Guaranteed Loans and thereby eliminate funds to the small business community. It would severely restrict one of the most vital programs. As a result, we believe it important to comment on those specific items that will be so detrimental.

1. **Charging Lenders 1% Of The Guaranteed Portion Of The Loan.**

It has been proposed that the lender pay a 1% fee to the SBA for the guarantee. This would be an addition to the borrower paying a 2% fee. This is simply another mechanism being used by the administration to reduce the amount of loans being made to the small business community. Every time a fee is charged it reduces a lenders desire to make a loan under the program. It does not make a better lending program, it removes lenders from the program.

2. **Charge Lenders 20% Of The Premium Earned On The Sale Of The Guaranteed Portion Of The Loan In The Secondary Market.**

This fee adversely affects the availability of profits to the lenders and will only serve to drive lenders out of the program, again reducing the flow of money to the small business community. Lenders must sell their loans in order to generate profits and additional funds to

small businesses. Reducing the profit potential will only induce lenders to look elsewhere for profits and steer them away from the small business marketplace. SBA would be better served in not reducing the capital flow to small business.

3. **Reduce The Guaranteed Portion To A Maximum Of 75%.**

This is a completely unacceptable approach to lenders because it will reduce their ability to obtain new capital for small businesses.

This one change alone will destroy the SBA Guaranteed Loan Program. Originally all loans were guaranteed 90%. This gave lenders the ability to sell 90% of their loan in the secondary market and thereby generate $9 of new moeny to lend for every $1 that they put up. This past April, 1986 the guarantee it was reduced to an 85% for loans over $155,000. Which meant that lenders could only borrower only $5.67 for each $1 that they had loaned to small business. That one action reduced the amount of capital available to the small business by 37%. This means that 37% of the capital that had previously been available to small business was taken away from them. The current proposal by the administration is to reduce the guarantee to 75% will mean that a lender can only borrower $3 for every $1 put in. Now in the span of less than one year the administration is proposing to reduce the capital available for small business by 67%. This is a drastic reduction of giving small business only 1/3 of the capital that was previously available to them.

What seems to be missing in the analysis made by the administration is that lenders depend on the SBA guarantee to be able to sell part of the loan in the secondary market and to be able to generate more capital to make small business loans. This is the same process used by the FHA to supply funds for housing loans.

When the guarantee was reduced from 90% to 85% it increased the amount of capital a lending institution had to put in each loan by 50% because on each $100,000 loan the lender could only sell off $85,000 not $90,000. The lender had to put in $15,000 instead of $10,000. This new proposal by the Administration would mean another reduction in the capital available for small businesses. This time there would be a 67% cut in the capital available for small businesses. Now a lender will have to put $25,000 of capital into each loan of $100,000 instead of $15,000.

This new cut in the guarantee by the administration is so drastic that it will drive lenders out of the market of making SBA guaranteed loans. We believe that 50% of the lenders currently in the program will leave the program if the guarantee is cut below the 85% because profitability will have been reduced from a gross margin of approximately 25% to one of 18%. No lending operation can exist on a gross margin of 18% because the gross margin is before all expenses including overhead, salaries, and any losses on their loans. I must report to you that my company would exit the SBA guarantee lending program if the SBA guarantee program lowers the guarantee below 85%. This will mean a loss of jobs in my own group but also a loss of funds to small businesses who employee new peop

The guarantee loan program is the only mechanism that permits small businesses to receive funds from the large US capital market. These guarantee loans are sold to large pension funds, insurance companies, and other large institutional investors. None of whom would ever make a small business loans but all are buyers of government guaranteed "paper." By the purchase of these loans capital is injected to aid the growth of small businesses throughout the United States.

While all Americans want to have the Federal Budget balanced, we feel that active SBA lenders and the small business community have worked to achieve this through the reduction to 85% guarantee and an increase in fees to 2% which became effective in April 1986. In a time when lenders and borrowers have compromised and accepted a reduced guarantee an increased fees we propose that the administration refrain from making, again, an attempt to dismantle the SBA's government guaranteed loans programs through lowering the guarantee amount and increasing fees.

Proposed Solution

Rather than to destroy the entire program, it would be better for the budget to be cut by 10% across the top of the government guaranteed program. That is, if the program was a $2 billion appropriation for the prior fiscal year we would propose reducing the guarantee amount by a 10% to $1.8 billion in loan guarantees. It is important to keep the program going even as a smaller program and hope that the economy and the government guarantees can pick up in future years when the economy comes back. To destroy the people working in the program, in industry and at the SBA is wrong. It will be difficult, if not impossible, to recreate this program in future years. It is better to have a small program today in the hopes that the future will allow the government to do more for the small business than to destroy the program today with changes to the guarantee amount.

We hope that members of the committee will not dismantle the SBA government guarantee program by implementing the OMB/SBA propossals. We ask the committee to prolong the program at a reduced rate rather than a completely destroyed program. I know members of the committee appreciate the job creation and the increased local tax base that is generated through the new business that are started with the government guaranteed loan program. I hope that the members of the Committee will see their way clear to make the program a smaller but viable program.

Very truly yours,

David Gladstone
President

DG/cpb

STATEMENT

OF

H. BRUCE LANSAW

Senior Vice President

First Huntington National Bank

Huntington, West Virginia

on behalf of

THE AMERICAN BANKERS ASSOCIATION

on

SMALL BUSINESS ADMINISTRATION'S BUDGET

before the

COMMITTEE ON SMALL BUSINESS

UNITED STATES SENATE

March 5, 1987

SUBMITTED FOR THE RECORD

Mr. Chairman and members of the Committee, I am H. Bruce Lansaw, Senior Vice President of First Huntington National Bank, Huntington, West Virginia, and Chairman of the American Bankers Association's (ABA) Small Business Banking Committee.

The combined assets of our members comprise approximately 95 percent of the total assets of the commercial banking industry. While our members range in size from the smallest to the largest banks, some 85 percent have assets of less than $100 million. I welcome the opportunity to present ABA's views on the programs of the Small Business Administration (SBA).

The First Huntington National Bank is actively involved in SBA programs. First Huntington currently serves the tri-state area of West Virginia, Southern Ohio and Eastern Kentucky. The bank has been a SBA lender for the past 15 years and is currently a Preferred and Certified SBA lender, with approximately $8 million outstanding in SBA guaranteed loans. These small business loans aid over 80 businesses. The range of businesses served, including start-up and mature companies, has provided many benefits to our community.

Mr. Chairman, the banking industry has been a major participant in various SBA programs for years. Approximately 10,000 banks have been involved in the SBA loan programs. A primary example is the loan guarantee program, which was authorized by Section 7(a) of the Small Business Act of 1953.

This program benefits the national economy and small communities through the jobs created and revenues produced by the small businesses that use the program.

Mr. Chairman, small businesses are major creators of new jobs. They make substantial contributions to our national economy. The SBA loan guarantee program is a very real factor in enabling commercial banks to assist all small businesses, but especially new, start-up companies that desperately need long-term financing.

The ABA has consistently supported the 7(a) loan guarantee program because it benefits small businesses by providing this very important long-term financing. In 1985, during the debate over reauthorization of SBA, the ABA supported increasing the guarantee fee for these loans from 1 percent to 2 percent and reducing the maximum guarantee from 90 percent to 85 percent for loans over $155,000 to reduce the costs of the program and contribute to reducing the Federal deficit. These changes were made and are now law pursuant to Public Law 99-272.

Since these reduced guarantee levels and increased fees have been incorporated into the SBA programs, the ABA opposes attempts to further reduce the guarantee levels or increase fees, at least until the SBA must be reauthorized in 1989.

The SBA guarantees are important to banks because it is the guarantees that protect the safety and soundness of the financial institutions and satisfy bank regulators while more credit is provided to small businesses that

could not otherwise secure long-term financing at a reasonable rate. For the small business, the guarantees permit longer-term amortization of loan repayments, thus reducing cash flow pressure and contributing to business growth and economic viability.

If it is desirable to maintain this public policy in support of small business, then it is the consensus of the ABA's Small Business Banking Committee that current guarantee levels for financial institutions and manageable debt service for small businesses should be maintained. Therefore, the ABA Small Business Banking Committee opposes the Administration's budget proposal to reduce the maximum loan guarantee to 75 percent by 1992.

In March, 1985, my predecessor as ABA's Small Business Banking Committee Chairman, John McClure, submitted testimony to this Committee. I would like to quote from his testimony concerning the 7(a) Loan Guarantee Program:

> This program already transfers much of the administrative and servicing expense to the lending banks. This results in a cost of delivery to the Federal Government which should compare very favorably with the efficiency and cost of other federally-sponsored economic development or public assistance programs. To help fund program costs, we support a guarantee fee of 2 percent. However, we think any increase above that percentage would retard bank participation in the program.

The ABA's Small Business Banking Committee recently met and reaffirmed this position. Increasing the guarantee fee, whether charged to the borrower or the lender, will retard bank participation.

ABA's Small Business Banking Committee opposes the Administration's proposal to charge lenders 20 percent of earnings on the sale of the

passed amendments in 1984 to facilitate the development of this secondary market as an incentive to lenders to participate in the program.

The secondary market works. It is an incentive for lenders. Further, in capital poor areas, these loan sales help lenders' liquidity by returning funds to the originating bank which becomes available for additional lending to small businesses. (Although lenders sell the loans, they retain loan servicing and their relationship with the small business customer.) To impose a new charge on the income earned from these sales into the secondary market will defeat the purpose of the 1984 amendments that expedited its development. Due to the infancy of these changes, time is needed to permit their maturity. Such a fee, at this time, would virtually kill this program and would retard lender participation in the 7(a) guaranteed loan program.

Lastly, ABA's Small Business Banking Committee does not oppose the sale of SBA's loan portfolio in principal. However, we believe strongly that such sales should only be authorized on the best possible terms and only if the sales benefit the ongoing SBA loan programs. We urge this committee to examine carefully all proposals to sell SBA's loan portfolio, and to support such sales only if they will benefit the goal of continued Federal support for small business.

In conclusion, Mr. Chairman, the ABA's Small Business Banking Committee continues to support the SBA and its programs. We believe that the actions taken during the reauthorization of SBA to reduce program costs were responsible. We are working with the programs. Making changes in these

programs such as reducing the guarantee levels or increasing fees will reduce program participation and not just because the change in loan terms will make the programs less accessible to some small businesses. Program participation will be reduced because yearly uncertainty about SBA loan program terms results in frustration and lack of interest on the part of both small business borrowers and lenders.

The SBA programs in which our member banks are participating work quite well. If changes to these programs are contemplated, they should be examined during the reauthorization process in 1989.